RATING REPORT

U Microfinance Bank Limited (UMBL)

REPORT DATE:
May 06, 2020

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-1	A	A-1
Rating Date		*April 30, '20*	*January 11, '19*	
Instrument	A-		A-	
Rating Outlook		*Rating Watch Developing*	*Stable*	

COMPANY INFORMATION	
Incorporated in 2003	**External auditors: KPMG Taseer Hadi & Co. Chartered Accountants (2018)**
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, 2016) & Notching the Issue (June, 2016)*** **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 over 18 years.

Financial Snapshot

Total Equity: FY19: Rs. 3.1b; FY18: Rs. 2.8b; 2017: Rs. 1.4b

Net profit: FY19: Rs. 254m; FY18: Rs. 547m; FY17: Rs. 259m

RATING RATIONALE

The assigned rating to UMBL reflects its association with a strong sponsor, Pakistan Telecommunication Company Limited (PTCL). PTCL has been assigned an entity rating of AAA/A-1+ (Triple A/A-One Plus) and 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. The implicit support from the sponsor was witnessed with the recent conversion of Tier-II Subordinated Debt amounting to Rs. 800.m into common equity to relieve the stress on capitalization indicators of the bank. The revised business strategy aiming for increased market penetration and enhanced geographical outreach culminated in expansion of branch network leading to increase in market share of the bank to 7.2% (FY18: 6.2%) during the outgoing year. 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. In terms of liquidity position the bank is comfortably placed. The ratings reflect downturn in the financial risk profile of the bank owing to higher incidence of non-performing loans leading to higher infection ratios; the same is a result of deterioration in sector dynamics prior to advent of COVID-19 pandemic. The downturn in asset quality has put a drag on the institution's profitability.

With the advent of global corona virus pandemic and the following lockdown, the microfinance borrowers will have a further reduced capacity of meeting obligations. Given UMBL has a predominantly bullet repayment structure, the ratings take into account SBP's relaxation on repayment terms for borrowers by giving a blanket extension of one year. This is likely to stagger the infection ratios, which may come forth in FY21. Status of the rating is therefore uncertain, as an event of deviation from expected trend has occurred; additional information will be necessary to take any further rating action, warranting a 'Rating Watch' status. Going forward, ratings are dependent on improvement on asset quality indicators, strengthening of deposit profile, maintenance of liquidity indicators and retention of buffer over regulatory capital requirement.

Credit Risk UMBL: With growth in active loans and higher average loan size, gross advances portfolio of the bank increased by around 27.% and amounted to Rs. 21.8b (FY18: Rs. 17.2b) by end-FY19; leading to an increase in market share of the bank. U Livestock remained the flagship product of the bank as it constituted around 40% of the overall portfolio. These are bullet structure loans extended and are backed by group guarantee. Going forward, the management plans to reduce concentration of U Livestock by increasing proportion of other existing products in the mix. Moreover, majority of the loan portfolio is concentrated in Punjab signifying low geographical diversification. With opening of new branches in the outgoing year the management plans to achieve further geographical diversification. Credit risk emanating from microcredit portfolio exhibited an increasing trend indicated by higher infection ratio, which has plummeted for the past few years. The management must continue to ensure prudent risk management as majority of the portfolio comprises agricultural & livestock based loans and entails bullet repayment. Future trend with respect to asset quality indicators will continue to be tracked by VIS.

Liquidity: PTCL injected Tier 2 capital of Rs. 4b during FY18. The Tier-2 capital has a tenor of seven years with five years grace period. As per management, excess funds have been placed at higher rates with other financial institutions translating into a spread for the Bank. In addition, the bank has access to sizeable short term running finance lines. With surplus liquidity utilized towards financing activities, liquid assets-to-total deposits & borrowings marginally declined during the review period. Deposits remained the primary funding source for the bank; the increase was largely manifested in fixed deposits while depositor concentration remained high as top 50 depositors accounted for 54% (FY18: 55%) of total deposits. Therefore, until granularity of deposits is improved, the bank has to maintain adequate liquidity buffer to meet the risk of withdrawals. Going forward, the management plans to increase granularity by introducing low-ticket sticky deposits through branchless banking project. Improvement in deposit profile (including depositor concentration and mix) remains a key focus area of the management. Focus of new branches being opened will also be on deposit mobilization apart from undertaking financing activities.

Profitability: Despite increase in mark-up spreads and slight increase in the number of loans disbursed, profitability of the bank took a downward trend primarily owing to exponential increase in administrative and provisioning expense of the bank. Given higher provisioning expense recorded coupled with sizable increase in administrative expenses on account of geographical expansion, Operating Self Sufficiency (OSS) declined on a timeline basis. Going forward, profitability of UMBL is projected to depict positive momentum owing to growth in financing portfolio only if the deteriorating asset quality indicators are addressed. Maintaining asset quality indicators will remain a key rating driver.

Capitalization: By end-FY19, equity of the bank augmented on the back of internal capital generation. However, Capital Adequacy Ratio (CAR) of the bank decreased slightly to 16.67% (FY18: 19.05%) by end-FY19 on account of growth in the microcredit portfolio. Given growth plans, sizeable internal capital generation would be required to maintain CAR above the minimum regulatory requirement. The same is likely to be attained if the deterortaion in asset quality is countered effectively.

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U Microfinance Bank Limited (UMBL) Appendix I

FINANCIAL SUMMARY			(Rs. In millions)
BALANCE SHEET	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**
Net Investments	1,786	1,968	6.970
Net Financing	10,554	17,020	21,374
Cash Balances	3,359	12,484	4,737
Total Assets	17,631	34,792	40,090
Total Deposits	11,971	20,535	23,290
Borrowings	3,069	6,010	6,733
Paid Up Capital	2,286	2,286	2,286
Tier-1 Equity	1,379	2,809	3,051
Net Worth	1,379	2,809	3,060
INCOME STATEMENT	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**
Net Mark-up Income	1,493	2,690	3,424
Net Provisioning / (Reversal)	86	260	838
Non-Markup Income	458	640	939
Operating Expenses	1,447	2,268	3,206
Profit Before Tax	407.6	784	304
Profit after tax	259.0	547	254
RATIO ANALYSIS	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**
Gross Infection	0.45%	1.27%	4.10%
Incremental Infection	0.6%	2.3%	6.2%
Provisioning Coverage	28.1%	33.2%	39.3%
Net Infection	0.33%	0.85%	2.53%
Net NPLs to Tier-1 Capital	2.5%	5.2%	17.8%
Capital Adequacy Ratio	16.6%	20.5%	16.7%
Cost of Deposits	9.5%	9.2%	11.6%
Markup Spreads	20.0%	17.6%	20.5%
ROAA	2.31%	2.09%	0.68%
ROAE	29.6%	26.1%	8.6%
Liquid Assets to Total Deposit &Borrowings (%)	34.0%	54.4%	39.0%
Current Ratio (x)	NA	NA	NA

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-V

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				
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				
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.
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