RATING REPORT

NRSP Microfinance Bank Limited

REPORT DATE:
April 27, 2023

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB+	A-2	A-	A-1
Rating Outlook	Rating Watch - Developing		Negative	
Rating Date	*April 27, '23*		*April 29th, '22*	

COMPANY INFORMATION

Incorporated in 2008	**External Auditors:** M/s A. F. Ferguson & Co., Chartered Accountants, a member firm of the PwC network
Public Limited Unlisted Company	**Chairman of the Board**: Dr. Rashid Bajwa **Chief Executive Officer**: Mr. Zahoor Hussain Khan
Key Shareholders (with stake 5% or more):	
National Rural Support Program (NRSP) – 57.40%	
International Finance Corporation (IFC) – 16.02%	
PROPARCO France – 15.91%	
Acumen Fund – 10.68%	

APPLICABLE METHODOLOGY(IES)

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

NRSP Microfinance Bank Limited

OVERVIEW OF THE INSTITUTION

NRSPB is licensed by SBP to operate as a nationwide microfinance bank under the Microfinance Ordinance, 2001. The bank provides microfinance services to the rural low-income sector with an overall objective of mitigating poverty and promoting social welfare.

Profile of Chairman

Dr. Rashid Bajwa is the current Chief Executive Officer (CEO) of the National Rural Support Program (NRSP). Mr. Bajwa also holds various honorary positions such as Director of Pakistan Microfinance Network, Member of State Bank of Pakistan's committee of Rural Finance and Sindh Rural Support Program.

Profile of President/CEO(A)

Mr. Riaz Bangash is a seasoned banker and possesses rich experience in banking spanned over 30 years+. He has good knowledge and understanding of commercial, SME, Consumer and Microfinance banking. He holds an MBA degree from IBA-Karachi and JAIBP (with distinction in credit management) from Institute of Bankers Pakistan. He has attended several strategic level training programs at Frankfurt Business School, LUMS, British Council, World Bank, Stephen Covey, IBP, etc. Prior to

RATING RATIONALE

Rationale:

The assigned ratings of NRSP Microfinance Bank Limited Bank Limited ('NRSPB' or 'the Bank') incorporate presence of reputable sponsors carrying reasonable experience and understanding of the microfinance sector. Sponsor's commitment has historically been demonstrated by way of both technical and financial support. VIS anticipates forthcoming support in the foreseeable future. The ratings encapsulate the lingering impact of Covid-19 along with the impact of dismal macroeconomic indicators wherein portfolio credit quality has been impacted and the financial risk profile of the Bank has weakened. The deterioration of asset quality has led to a sizable negative bottom line which in turn has pushed the already non-complaint capital adequacy ratio (CAR) to negative by end of the outgoing year. The revision in ratings takes into account the delay in equity injection proposed by the sponsors along with escalated level of credit risk faced by the Bank during the rating review period. Cognizant of the increased credit risk prevalent in the sector, the management has taken measures including increased focus on EMI-based products and lowering exposure to un-secured segments.

The ratings factor in contraction of spreads on account of reduced yield of micro-credit portfolio in line with suspended income on non-performing loans (npls) along with higher cost of funding originating from policy rate hikes evidenced during the outgoing year. Subsequently, to mitigate the increasing funding cost, NRSPB has strategically reduced higher costing fixed deposits during FY22. Further, the liquidity position was also marked by a downturn as evidenced from coverage of liquid assets by deposits and borrowings on account of divestment from liquid avenues along with cashflow constraint faced owing to low recovery ratio in light of internal restructuring carried out largely culminating in npls. The ratings take note of additional equity injection to the tune of Rs. 3.5b along with sizable recoveries from written-off portfolio and outstanding npls expected in the ongoing year to bridge the capital shortfall in order to make the CAR complaint with the regulator requirement. The ratings will remain dependent on successful and timely execution of both planned equity infusion and improvement in portfolio health through recoveries. Moreover, the strengthening of profitability and liquidity metrics is also important for the sustenance and review of ratings.

NRSP Microfinance Bank Limited: NRSPB was incorporated as a public limited unlisted company in 2008 under the Companies Ordinance, 1984. The Bank has a license from SBP to function as a nationwide microfinance bank (MFB) under the Microfinance Ordinance, 2001. NRSPB is engaged in provision of conventional and Islamic microfinance services to low-income rural sector with the ultimate objective of poverty alleviation and promoting social welfare. NRSPB operates through a network of 145 branches as at Dec'22 (Dec'21: 150 branches), including 40 Islamic branches (Dec'21: 40 branches). Registered office of the Bank is situated in Islamabad, while the head-office is based in Bahawalpur.

Board of Directors & Management

The Board of Directors (BoD) at NRSPB currently comprises of 8 members, including 4 nominee directors from NRSPB, an independent director, a nominee director from Acumen Fund and Proparco each and the CEO. Dr. Rashid Bajwa, continues to chair the BoD. All members of the BoD possess extensive local and international experience in the microfinance & banking sector. BoD composition is provided.

joining NRSP MF Bank, he had been associated with Habib Bank Limited, Askari Bank Limited and The Bank of Khyber.

Table 1: Board of Directors

Directors	Status
Dr. Rashid Bajwa	Chairman/NRSP designate
Ms. Shahida Jaffrey	NRSP designate
Mr. Shoaib Sultan Khan	NRSP designate
Mr. Fazlullah Qureshi	NRSP designate
Dr. Ayesha Khan	Acumen designate
Mr. Stephen Rasmussen	Independent Director
Mr. Riaz Khan Bangash	CEO/President (A)
Mr. Jesse C. Fripp	Proparco Nominee

Distribution Network

Number of branches of the Bank declined to 145 as at Dec'22 (Dec'21: 150), including 39 Islamic branches (Dec'20: 40), as the management is currently focused towards consolidation and recovery of the existing portfolio. Branch network is mainly concentrated in Punjab followed by KPK. Given weak fundamentals of the Bank, there is currently no plan to open any new branches in the ongoing year. However, investments in the Digital Financial Services (DFS) platform will continue. NRSPB is focused on providing financial services through digital means to the masses, specifically to women who fare very poorly in terms of financial inclusion. Key financial services offered to clients are Electronic Loan Applications, Remote Account Opening, Internet Banking, Android/iOS Applications, Bio Metric Verification and a Corporate Banking Portal.

Productivity Analysis

In view of the ongoing consolidation strategy, the Bank undertook some staff rationalization measures during the period under review. With reduction in the branch network, the strength of Loan Officers (LOs) employed was also scaled down. In addition, stemming from consolidation of operations, the Bank's productivity indicators were affected with active borrowers to LO and active borrowers to branch declining during the period under review; the same can impact the efficiency and profitability indicators of the Bank going forward.

Table 2: Productivity Indicators

LO's Productivity	2021	2022
No. of LOs	1,305	1,252
No. of Branches/Locations	150	145
No. of Active borrowers	316,231	258,937
Average LOs/Branch	9	9
Average loan/LO (Rs. m)	23.6	25.9
Active borrowers/LO	242	207
Active borrowers/branch	2,108	1,786

Operating Cost Rationalization for FY23

Given spiraling inflation, high cost of utilities and induction of recovery staff, minimizing admin cost has become a serious challenge. However, the Bank is trying to reduce overall admin cost from 12% of net advances in FY22 to 11% in 2023 and gradually it would be further reduced to 9% in the coming years. Currently, operational cost of microfinance industry stands at 13% approx., which indicates that the Bank is already taking measures to operate on a lower admin cost. In addition to cost control measures, the management is also working on feasibility of merging certain branches and to convert branches into service centers to reduce cash handling costs.

Internal Audit

Internal Audit Department (IAD) of NRSPB is divided into 5 domains i.e., Branch Audit, Head Office Audit, Shariah Audit, Information System (IS) Audit, and Quality Assurance. The Bank follows a risk-based approach towards evaluation of branches. Depending on assessed risk, branches are classified into one of the five categories, ranging from 'good', 'fair', 'satisfactory', 'substandard' to 'poor'. In addition, resources were aligned to increase the monitoring of gold-backed lending during the review period. Moreover, overall compliance level was found satisfactory. The audit and reviews conducted during the year include; Branch Audits, Management Audits/reviews, Shari'ah Audits/reviews, IS Audits/reviews. In line with sizable reporting of npls highlighting credit and operational risk issues, an adverse trend in risk rating of branches was evidenced during the outgoing year. Branch risk ratings are tabulated below:

Table 3: Branch classifications

	2021	2022
Good	2	0
Fair	18	3
Satisfactory	55	42
Substandard	36	58
Poor	1	7
Total Branches Audited	**112**	**110**

Risk Management

Risk Management Department (RMD) at NRSPB is divided into 4 domains i.e. Credit Risk, Operational Risk, Market & Liquidity Risk, and Information Security. Credit risk function has resources, including Credit Risk Analysts (CRAs) reporting to the Assistant Manager (AM) – Credit Risk, and Credit Risk Officers (CROs) and Regional Risk Officers (RROs) reporting to the Team Leader (TL) – Credit Risk. AM and TL – Credit Risk report to the Risk Manager, who in turn, reports to the Head – Risk Management. CROs and RROs are responsible for ensuring portfolio quality by reviewing branch portfolio on a sample basis through physical verification while CRAs are responsible for risk assessment prior to forwarding the documentation for loan booking. Meanwhile, TLs are look after hiring and retention of CROs while also supervising their work on sample basis.

Credit Risk Unit (CRU) identifies, assesses and monitors credit risk and advise senior management and others stakeholders on how to mitigate these risks. CRU regularly reviews the portfolio to assess portfolio risks, reviewing metrics from geographic, sector, product & branch concentrations, while also monitoring adequacy of reserves & cushions to cover potential loan losses. Credit Risk Management Unit identifies risks at product, portfolio and transaction level.

Operational Risk identifies, assesses and monitors operational risks and notifies the management about areas of non-compliance in all operational activities of the Bank in the ORMC/ORPC meetings. Market and Liquidity risk unit identifies, assesses and monitors Market/Treasury related risks and recommend risk mitigation to control these risks to Senior Management/CEO. In view of the strategy shift, pre-disbursement verification was halted and focus was increased towards verification of large-sized loans and gold-backed lending. Board supervision on portfolio quality has also increased during the year to track the impact of pandemic-induced economic turmoil

Information Technology

NRSPB is using Oracle Super Cluster M-7 for its Core Banking System (CBS) Infrastructure. The Bank has taken series of upgrades for its CBS and virtualized platforms along with security appliances to meet the customer demand of smooth, secure and real-time offering of banking services. At software layer, database and operating system were also upgraded to latest available versions that are equipped with emerging features and bug fixes. NRSPB was the first bank in microfinance sector to go live with SBP RAAST Platform. The Bank has customer digital onboarding system in place by which customers are able to self-serve using their smart phones / tablet / computer for digital account opening. NRSPB is also integrated with NADRA to provide online biometric verification services to its customers using the mobile application.

Furthermore, NRSPB has developed multiple digital channels for effective loan recoveries, which includes mobile apps, 3rd party agent networks and integrations with other banks to collect loan recoveries on behalf of the Bank. Recently, disaster recovery (DR) data center was upgraded by deploying oracle Sparc T-8 servers and storage. Further, NRSPB has joined strategic partnership with Telemart to offer Shariah complaint mobile handset financing services through the Islamic banking division. The Bank has also taken measures to protect the digital assets by using advanced threat intelligence tools named TrendMicro deep security. Deep Security delivers timely protection from attacks by leveraging the latest global threat intelligence via the Trend Micro™ Smart Protection Network.

During the period under review, IT department has explored a monitoring app to record daily visits of staff and to save clients' location. To improve controls over collection/recovery at field level, an auto SMS is sent to client for amount received by the Bank through recovery app. The call center checks the recovery report and call the customer, if needed. All loans are processed through Electronic Loan Application (ELA) system which was developed in house. The ELA has built-in controls so that no loan can be processed without compliance of SOPs set for the loan approval.

Financial Analysis

Asset Mix & Investment Portfolio

Total asset base of the Bank declined by 14% to Rs. 44.2b (Dec'21: 51.4b) by end-FY22; the drop was precipitated by NRSPB's deposit attrition, decline in borrowings and sizable loss incurred in the outgoing year which notably impacted the Bank's equity base. The decline in asset base was mainly manifested in the investment portfolio, balances with other banks and other assets. However, net advances portfolio depicted a growth of meager 3% increasing to Rs. 28.0b at end-FY22 (FY21: 27.2b).

Table 4: Assets

In Rs. Millions	Dec'21	%	Dec'22	%
Net Investments	6,782	13.2	2,436	5.5
Net Advances	27,179	52.9	28,028	63.4
Bank placements	6,807	13.2	4,369	9.9
Cash & balances with SBP/NBP	2,612	5.1	1,820	4.1
Lending to FIs	-	-	-	-
Fixed & other assets	8,002	15.6	7,538	17.1
Total Assets	**51,381**	**100**	**44,191**	**100**

Investment portfolio of the Bank decreased as an outcome of liquidation of investment in T-bills and TDRs; investment in TDRs was completely liquidated (FY21: Rs. 1.8b) by end of the outgoing year. The credit risk emanating from investment portfolio is non-existent as government securities accounted for 100% (FY21: 73%) of the investment mix. Moreover, given that the entire investment is placed under held to maturity on amortized cost the same is not susceptible to mark-to-market losses due to interest rate fluctuations. Hence, the market risk is also negligible.

Credit Risk

Consolidation strategy opted for gross loan portfolio (GLP):

The gross micro-credit portfolio only increased slightly to Rs. 32.4b (Dec'21: 30.8b) by end-FY22 as the management had adopted consolidation strategy since the past two financial years owing to deterioration of asset quality indicators on a timeline coupled with breach of regulatory CAR. The higher loan disbursements amounting to 28.6b (CY21: 26.5b) resulting in an aforementioned increase in GLP was an outcome of higher average ticket size recorded at Rs. 140, 978 (CY21: Rs. 109,085); the same in turn was a function of increased lending in high-ticket size housing segment along with progression of clients to successive loan cycles wherein automatic increase in renewal loan is inbuilt. On the flip side, as a result of complete halt on new unsecured lending total number of active borrowers decreased to 258,952 in CY22 (CY21: 316,231). Subsequently, in line with asset quality and capital erosion challenges faced along with increase in overall GLP of the country's microfinance sector, NRSPB's market share scaled down to 6.6% at end-FY22 as opposed to 7.9% in the preceding year. Till the capital shortfall is not replenished through equity injection and recoveries from written-off portfolio, the growth avenues are completely inaccessible.

Deferred, Restructured, Rollover (DRR) Portfolio:
As at Dec'22, the deferred portfolio pertaining to regulatory relief under Covid-19 decreased sizably to Rs. 771m (Dec'21: 4.5b) as the scheme matured on Mar'21. Under the SBP relief package, the regular/performing borrowers were allowed to reschedule/defer their loans in accordance with the SBP guidelines. However, the same is not a true reflective of bank's high-risk portfolio as significant restructuring has been carried under bank's internal rescheduling scheme post SBP's deadline. The portfolio rolled over under bank's internal scheme constituted an amount of Rs. 3.2b initially during FY21 which declined to Rs. 2.6b as at Dec'22; out of the total, Rs. 398m was recovered and Rs. 191m was written-off after approval by the Board during the period under review. Subsequently, the entire remaining portfolio amounting to 2.6b now falls under NPLs classification. Cumulatively, total npls emanating from DRR and internally restructured portfolio were recorded at Rs. 3.4b, constituting around 12% of the net advances at end-FY22. Further, the aggregate write-off amounted to Rs. 1.7b at end-FY22. On the other hand, total provision against internally rolled over portfolio was recorded at Rs. 1.08b as at Dec'22. Remaining provisioning of Rs. 1.5b in line with extension approval received from SBP would be made in CY23.

Table 5: DRR Portfolio

Rs. in M.	2020	2021	2022
Restructured under SBP Scheme			
Opening	-	6,830	4,542
Deferred/Restructured	10,789	1,876	477
Amount recovered till date	3,959	3,663	2,747
Written-off	0	501	1,501
Closing	6,830	4,542	771
Restructuring Internally			
Opening	-	-	3,124
Deferred/Restructured	-	3,206	0
Amount recovered till date	-	82	316
Written-off	-	0	191
Closing	-	3,124	2,617
Provisions held	-	847	1,083

As per the management, given the Bank does not operate in flood-hit areas, the amount of portfolio impacted was insignificant. However, the lumpy skin disease of livestock has impacted the recovery of loans during the outgoing year.

Asset Quality:

NRSPB's asset quality indicators have been under pressure since CY18 due to factors including high inflation, low crop yield, over-indebtedness of borrowers and unexpected weather conditions. However, the outbreak of Covid-19, related lockdowns and the following economic downturn has further amplified the credit risk. Around 39% of the entire micro-credit portfolio was rolled over under SBP's relaxation of deferring repayment by one-year during CY20. Further, internal restructuring was carried out for borrowers largely pertaining to the ones already provided relaxation under SBP relief. The elevated credit risk on this double restructured portfolio is a function of stressed credit repayment capacity amid worsening macroeconomic indicators. As a result, NPLs of the Bank increased to Rs. 5.2b as opposed to Rs. 2.1b in FY21; out of the total NPLs, Rs. 3.4b pertain to DRR and internally restructured portfolio while remaining Rs. 1.8b reflect infection of normal portfolio at end-FY22. Therefore, gross infection increased sizably on a timeline basis by end of the outgoing year.

Against the internally restructured portfolio of Rs. 3.2b, the Bank recorded general provision amounting to Rs. 2.1b in FY21. During the year under review, NRSPB reversed the aforementioned general provision and classified the portfolio as loss and 100% specific provision amounting to Rs. 4.2b was booked as per prudential regulations. Nevertheless, despite switching of Rs. 2.1b from general to specific provisioning, the net infection was recorded higher at end-FY22 owing to sizable npls reported along with provision staggering allowed by central bank.

Further, the advances charged off against provisions stood higher at Rs. 3.9b (FY21: Rs. 1.6b) at end-FY22; meanwhile, bad debts directly written off stood at Rs. 12.5m (FY21: 30.4m); however, the proportion of the same is insignificant in comparison to total write-offs for the year. With sizable quantum of write-offs added, the incremental infection also showed worsening and was recorded higher at end-FY22. However, in line with switching of general provisioning to specific provisioning, the provisioning coverage (only specific provision) improved during the outgoing year; the same was also in line with relaxation allowed by the central bank. 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. The asset quality indicators are presented in the table below:

Table 6: Asset Quality

Rs. Million	CY21	CY22
Gross Advances	30,848	32,386
Specific Provision	1,333	4,157
General Provision	2,336	201
Non-performing Advances	2,122	5,169
Net Advances	27,179	28,028
Gross Infection (%)	6.9%	16.0%
Net Infection (%)	2.7%	3.6%
Incremental Infection (%)	8.7%	2130%
Provisioning Coverage (%)	62.8%	80.4%

With portfolio consolidation the main objective of the Bank, focus would be on recovery of stuck-up loans in 2023 and 2024. Further, to improve credit discipline and create deterrence, legal actions have been initiated in each village. However, due to the slow legal processes, the action against delinquent clients is taking time. Portfolio is mapped and loan officers have been deployed in high-risk areas. Frequency of in-person and telephonic follow-ups has been increased to ensure timely collection. Moreover, a specific team has been established at the head office to monitor collection performance.

Targets of LOs have also been revisited for proper and effective monitoring. In addition, management level NPL Committee has been established to identify the main reasons of non-repayment and propose recovery measures accordingly in the outgoing year. In line with aforementioned structural changes, the management is hopeful that during the ongoing year 2023, recoveries of around Rs. 3-3.5b will be made from the written off portfolio (net of recoveries) in the last four years coupled with outstanding NPL.

Microcredit Portfolio Risk Segregations

In terms of sector-wise concentration, keeping in view the changing risk dynamics of agriculture and livestock sector, NRSPB consciously reduced new lending under both segments over the past years. Resultantly, their share has declined in loan portfolio mix as at Dec'22. Going forward, in line with historically high infection recorded, the management plans to cap agri and livestock combined at 45% in the medium term. In addition, the Bank is moving towards secured segments in an effort to improve portfolio quality. Therefore, gold and housing segments represented a larger chunk of GLP at end-FY22.

Table 7: Sector-wise Segmentation

(Rs. in billions)	CY21	%	CY22	%
Agri	14,403	47%	13,253	41%
Enterprise	6,240	20%	6,758	21%
Gold	3,708	12%	6,417	20%
Housing	2,523	8%	3,646	11%
Livestock	3,209	10%	1,685	5%
Others	765	2%	627	2%
Total	**30,848**	**100%**	**32,386**	**100%**

The proportion of secured portfolio increased sizably during the outgoing year in line with higher lending in gold and asset-based portfolio under Housing segment. The secured lending portfolio is expected to be increased to Rs. 21.3b with a contribution of 56% to GLP to manage credit exposure by end-FY23. In addition, in terms of type of payment, the share of EMI increased during the rating review period. The business approach entails implementation of portfolio consolidation strategy with maintenance of GLP at around Rs. 32b, reduction in exposure to high-risk and loss-making segments and continuation of new business by replenishing the gaps through lending in more stable and secure segments. In regard to this, new-to-bank disbursement under unsecured-bullet portfolio has been completely discontinued for the foreseeable future.

Table 8: Bullet vs EMI & Secured vs Unsecured

(% concentrations in advances)	CY21	CY22
Bullet	76%	62%
Installment	24%	38%
Secured	39%	49%
Unsecured	61%	51%
Total	**30,848**	**32,386**

Strategy for Managing Elevated Level of Credit Risk for FY23

To improve monitoring mechanism, tagging of all type of loans has been revisited by LOs and village / moza / union counsel. Instead of leaving the job of recovery and follow-up to AMs and BMs only, a centralized monitoring unit has also been established; each person of that unit is assigned 10 branches to monitor daily progress. For gold backed loans, three Shroofs (gold smiths) are enlisted per branch and higher amount loans are verified by at least two different Shroofs. The loans under corporate guarantee of sugar mills are also being processed after due verification of clients. It is targeted to develop a dedicated cadre of recovery staff of 850 persons by end of the ongoing year. Normal LOs would be shifted to recovery team and some hiring will be carried out as per need. In addition, under-performing staff would be laid-off. Therefore, total credit staff is expected to remain around the same level as of outgoing year. Further, significant recovery is also expected from recovery suits, legal actions under Land Revenue Act and FIRs against guarantee cheques. In the first six months of 2023, target of recovery is kept on a lower side as significant amount against normal portfolio is also due, therefore the main focus is to minimize further NPLs. However, in the last six months of the ongoing year as due amounts are less, higher recovery from old stuck-up is projected.

Liquidity Risk

NRSPBs liquidity position was marked by a downturn on account of multiple factors including liquidation of investments, reduction in balances held with financial institutions and cashflow constraint faced due to low recovery ratio in light of sizable internal restructuring carried out largely culminating in npls during the period under review. The drop in liquidity indicators is further underpinned by the fact that despite all the above-mentioned liquidity stress indicators, additional liquidity was parked in micro-lending with net advances to deposits ratio (ADR) increasing to 86.3% (FY21: 80.0%) at end-FY22.

Overall, the Bank's total liquid assets decreased to Rs. 8.6b (FY21: Rs. 16.2b) owing to reduction in volume of investments vested in short-term government securities and TDRs. Subsequently, liquid assets to total deposits and borrowings stood lower at 22.1% (FY21: 38.1%) by end-FY22. Deposits continued to remain the primary source of funding for the Bank during the review period. In line with conscious effort of the management to curtail high-cost deposits, deposit base decreased to Rs. 32.4b (FY21: Rs. 34.1b) at end-FY22. The management intends to increase the deposit book to Rs. 39.1b with major volumetric increase manifested in fixed deposits by end-FY23; the same is realistic as in current high policy rate scenario investment avenues are largely replaced by savings owing to high return reaped.

The proportion of current and saving accounts (CASA) in overall deposit mix increased to 44% (FY21: 41%) owing to reduction in quantum of fixed deposits in absolute terms during FY22. Therefore, the share of fixed deposits decreased on a timeline basis by end of the outgoing year. Going forward, as per the tactical plan shared, after recapitalization of the Bank, the management intends to increase the ADR to around 95% for FY23. With the projected ADR, the prevalent strain on liquidity profile of the Bank is expected to continue in the ongoing year as well. Given, retaining and enhancing the quantum of current deposits has relatively become tough on account of benchmark rates being on the higher side creating significant opportunity cost against keeping capital in current accounts, NRSPB plans to maintain CASA proportion at 44% by end-FY23. The composition of deposit base is tabulated below:

Table 9: Deposits Mix

Rs. Millions	Dec'21	%	Dec'22	%
Fixed Deposit	19,996	59	18,020	56
Saving Deposit	10,646	31	10,531	32
Current Deposit	3,514	10	3,894	12
Total	34,127	100	32,444	100

Segment-wise breakup of deposits largely remained unchanged with 56% (FY21: 55%) of the deposit base constituting of institutional depositors. However, given the proportion of individual depositors is adequate, the granularity of the deposit base remained comfortable during the rating review period.

Table 10: Client-wise Segmentation

Rs. Millions	Dec'21	%	Dec'22	%
Individuals	15,485	45	14,173	44
Corporates	14,163	42	14,106	43
Banks/FIs	4,479	13	4,166	13
Total	34,127	100	32,444	100

Going forward, low cost, small ticket, sticky deposit generation will continue to be the main focus of the management. The concentration risk has marginally increased during the outgoing year, as top-50 depositors accounted for 50.6% as at Dec'22 (Dec'21: 49.1%); moreover, the same is on a higher side in comparison to peers. The increase in concentration risk is also reflected in the size-wise breakup of deposits as concentration of deposits falling in Rs. 10m and above bracket increased during the rating review period.

Table 11: Size-wise Segmentation

	Dec'21	%	Dec'22	%
Up to Rs. 25K	403	1.2	421	1.3
Rs. 25K - Rs. 100K	590	1.7	624	1.9
Rs. 100K-Rs. 1m	4,552	13.3	4,199	12.9
Rs. 1m-Rs. 10m	10,358	30.4	9,097	28.0
Rs. 10m and Above	18,224	53.4	18,104	55.8

NRSPB's total borrowings registered a decline to Rs. 6.6b (end-FY21: 8.4b) by end-FY22. Total borrowings include borrowings from banks and subordinated debts; the former decreased to Rs. 5.1b as at Dec'22 (Dec'21: 6.9b) as the Bank's reliance on deposits was recorded higher as evident from higher ADR recorded. The subordinated debt includes loan amounting to Rs. 672.4m (6m euros) acquired from KfW, Germany in order to finance the advances portfolio. The loan is availed as TIER-II subordinated debt for inclusion in the Bank's Supplementary Capital. The amount was translated into local currency at the exchange rate of Rs.112.06 and sub-ordinated debt of Rs 672,360,000 was recorded in the financial statements. The facility carries interest at rate of KIBOR + 3.5% per annum with principal and interest repayable in a bullet payment at the end of loan term by converting the principal and accrued markup into EUROs at the exchange rate prevalent as at June 30, 2023. All foreign currency risks in connection with the transaction rest with the KfW. The subordinated loan also includes an unsecured TFC amounting to Rs. 770m issued on July 09, 2021 to improve CAR at the rate of 3M-KIBOR plus 3% per annum. The issue is for a period of 7 years and will mature on July 09, 2028. The issue has assigned preliminary rating of single "A-" (Single "A minus"). The principal amount of issue TFC will be redeemed in four equal quarterly installments during the last year of the issue. The subordinated debt agreement has a call option exercisable after obtaining written approval of SBP at any time on or after a period of 5 years from the issue date. The issue has lock in and loss absorbency clause. Given, NRSPB is non-compliant on CAR, the Bank is abstained from making payments to instrument holders owing to lock-in clause being invoked as per SBP guidelines. Therefore, as per the management the sponsors of NRSPB have made the last three interest payments to subordinated debt holders after taking approval from SBP; the same is being recorded as liability in the Bank's balance sheet.

Profitability

NRSPB's profitability profile has deteriorated during the outgoing year in line with sizable cut in markup spreads and significant provisioning expense booked in line substantial npls emanating from rolled-over portfolio. 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. Therefore, despite slight growth in recurring non-markup income, primarily loan processing fee in line with increased lending of high-ticket loans pertaining to Gold and Housing categories coupled with higher recoveries from written off portfolio, Operational self-sufficiency (OSS) ratio showed a downward trend and was recorded low at 47.1% (FY21: 81.9%) during FY22. Subsequently with OSS recorded considerably lower than 100% indicating expenses are not being covered by income, NRSPB reported negative bottom line of Rs. 6.2b (FY21: Rs. 1.9b) during FY22 resulting in capital erosion and regulatory CAR breach.

The markup income earned was recorded lower to Rs. 4.2b (FY21: Rs. 8.0b) predominantly on account of sizable reduction in markup on advances to Rs. 1.5b (FY21: Rs. 5.7b) during FY22; the same was an outcome of lower yield on advances recorded at 15.5% (FY21: 27.9%) during the outgoing year as the GLP position largely remained unchanged. The yield on net advances dropped noticeably owing to suspension of income post classification of a performing loans along with markup waivers amounting to Rs. 436.3m (FY21: nil) offered to borrowers as part of restructuring carried out to combat higher credit risk situation. The suspended markup amount on npls was exponentially higher at Rs. 4.7b (FY21: Rs. 1.1b) in the outgoing year as the entire DRR and internally restructured portfolio was classified as npl during FY22. On the other hand, yield on government securities portfolio improved to 11.9% (FY21: 7.0%) in line with higher benchmark rates recorded during FY22. However, with sizable cut in yield on advances, overall yield on interest bearing assets decreased noticeably to 14.8% (FY21: 20.9%) during FY22.

Total markup expensed increased to Rs. 4.0b (FY21: Rs. 3.8b) despite reduction in deposit base and lower proportion of high-cost interest bearing deposits in the deposit mix in line with increased cost of funding to 10.2% (FY21: 8.6%) during the outgoing year on account of SBP's policy rate being at the very high end of the spectrum. The cost of deposits and cost of borrowings was recorded at 10.1% (FY21: 8.5%) and 10.3% (FY21: 9.5%) respectively during the outgoing year. Subsequently, in line with combined impact of drop in yield of earning assets and higher cost of funding, the Bank's markup spread declined to 4.6% (FY21: 12.3%) during FY22. Going forward, funding cost is likely to remain a challenge in the ongoing year in line with notable jumps in policy rate seen post-Dec'22. With frequent policy rate changes, the frequency of asset price reviews has completely changed with asset repricing now 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. The management plans to increase the loan pricing by 3-5% in the ongoing year. On the flip side, although the increase in prices on the lending side will rectify net interest margin compression; however, the same can escalate credit risk as with higher markup payments the already stressed credit repayment capacity of micro-credit borrowers will be further hampered.

With increased lending in higher ticket categories, microcredit application processing fee and commission increased to Rs. 479.5m (FY21: Rs. 390.2m) during the outgoing year. Moreover, other income also improved to Rs. 967.3m (FY21: Rs. 601.4m) due to higher recoveries against written off advances amounting to Rs. 886.8m (FY21: Rs.566.3m) recorded during FY22. Total administrative expenses of the bank increased to Rs. 3.4b (FY21: Rs. 3.2b) mainly on account of increase fuel and power expenses and higher legal charges; the same was a function of inflationary commodity super cycle experienced along with legal course of action adopted against delinquent clients. Loan loss provision was recorded higher at Rs. 4.6b (FY21: Rs. 4.0b) during FY22 in line with escalated credit risk owing to already impacted debt repayment capacity of borrowers post pandemic further aggravated by current dismal macroeconomic indicators. Subsequently, in line with decline with spreads and sizable provisioning expense booked, NRSPB reported sizable loss before tax (LBT) of Rs. 6.2b during FY22 as to opposed LBT of Rs. 1.9b in the preceding year.

Capitalization & Equity Replenishment Plan

The equity base of the Bank has dwindled to meager Rs. 89m (FY21: 4.3b) in line with revenue reserve reported negative at Rs. 2.5b on account of sizable loss reported during FY22. The Bank is required to contribute 20% of net profit to statutory reserve till the reserve fund equals the paid-up capital. Afterwards, the contribution is reduced to 5% of profit after tax. However, owing to incurrence of loss during the last two financial years no contribution to the reserve was made. Hence, the balance of statutory reserves remained unchanged at Rs. 815.8m (FY21: Rs. 815.8m) at end-FY22. In addition, the Bank is also required under the Microfinance Institutions Ordinance, 2001 to contribute 5% of annual after-tax profit to Depositors Protection Fund (DPF). Further, profits earned on investments of the fund are credited to DPF for the purpose of providing security or guarantee to specified persons for depositing money in the bank. Therefore, despite loss reported, Rs. 35.7m was transferred to DPF on account of return on investments. As a combined impact of reduction in core equity along with high incidence and reporting of npls, net NPLs as a percentage of the bank's Tier-I capital were recorded exponentially higher at 1137.6% (FY21: 18.4%) at end-FY22. Stemming from equity erosion on account of deteriorating asset quality, NRSPB reported capital shortfall of Rs. 7.7b, which after adjustment of Tier-2 Capital stood at Rs. 6.4b leading to CAR of the Bank recorded lower at negative 13.2% (FY21: 11.1%), at end-FY22.

Ultimately, NRSPB is non-compliant with minimum capital requirement (free of losses) of Rs. 1.0b and CAR of 15% as stipulated by regulations. The aforementioned conditions create a concern on the Bank's ability to continue as going concern. Subsequent to year end, the Parent Company has placed share deposit money of Rs. 1.0b in Feb'23 which will be converted to share capital ensuing the completion of regulatory requirements. The Bank has also devised business plan in collaboration with the Parent Company to seek additional equity injection of Rs.3.5b during the ongoing year so that minimum paid-up capital and regulatory CAR threshold is maintained and the Bank achieves growth and profitability. The Parent Company has confirmed its commitment for equity injection and unconditional financial support to the Bank to continue as going concern. The management believes that in view of above measures, NRSPB will be able to continue as a going concern, accordingly, the financial statements have been prepared on a going concern basis. Further, in addition to equity injection, the management is also hopeful to recover minimum of Rs. 3-3.5b from the total written-off portfolio (net of recoveries) during the last four years and outstanding NPL; the materialization of the same is expected to assist the Bank in becoming CAR complaint.

NRSP Microfinance Bank Limited — Annexure I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	31-Dec-19	31-Dec-20	31-Dec-21	31-Dec-22
Cash and Bank Balances with SBP and NBP	1,483	2,868	2,612	1,820
Balances with other Banks and/NBFIs/MFBs	3,967	4,933	6,807	4,369
Lending to Financial Institutions	-	1,495	-	-
Total Investments	1,590	8,638	6,782	2,436
Net Advances	27,371	27,932	27,179	28,028
Operating Fixed Assets	2,023	1,674	1,341	1,356
Other Assets	3,570	5,621	6,661	6,182
Total Assets	**40,005**	**53,161**	**51,381**	**44,191**
Total Deposits	26,651	39,285	34,127	32,444
Borrowings	4,437	4,068	8,378	6,587
Other Liabilities	4,230	4,298	4,597	5,067
Tier-1 Equity	4,684	5,498	4,277	89
Net Worth	4,688	5,510	4,279	93
Paid-Up Capital	1,498	1,498	1,498	1,498
INCOME STATEMENT	31-Dec-19	31-Dec-20	31-Dec-21	31-Dec-22
Net Mark-up Income	4,122	4,923	4,199	214
Net Provisioning / (Reversal)	1,845	1,741	3,988	4,591
Non-Markup Income	1,165	1,077	1,086	1,518
Operating Expenses	3,354	3,097	3,150	3,352
Profit Before Tax	87	1,144	(1,862)	(6,222)
Profit after tax	84	793	(1,232)	(4,218)
RATIO ANALYSIS	31-Dec-19	31-Dec-20	31-Dec-21	31-Dec-22
Gross Infection (%)	1.6%	4.2%	6.9%	16.0%
Net Infection (%) Specific	1.1%	2.8%	2.7%	3.6%
Incremental Infection (%)	6.3%	5.5%	8.7%	22.0%
Provisioning Coverage (%) Specific	31.5%	34.0%	62.8%	80.4%
Net NPLs to Tier-1 Capital (%)	6.6%	14.9%	18.4%	1137.6%
Capital Adequacy Ratio (%)	15.5%	16.8%	11.1%	-13.2%
Operational Self Sufficiency (OSS)	100.1%	133.2%	81.9%	47.1%
Markup on earning assets (%)	26.5%	25.7%	20.9%	14.8%
Cost of Funds (%)	11.0%	10.4%	8.6%	10.2%
Spreads (%)	15.5%	15.1%	12.3%	4.6%
ROAA (%)	0.2%	1.7%	-2.4%	-8.8%
ROAE (%)	1.8%	15.6%	-25.2%	-193.0%
Liquid Assets to deposits & borrowings (%)	22.6%	41.4%	38.1%	22.1%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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	NRSP Microfinance Bank Limited
Sector	Micro Finance Bank
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
27-Apr-2023	BBB+	A-2	Rating Watch Developing	Downgrade
29-Apr-2022	A-	A-1	Negative	Downgrade
29-Apr-2021	A	A-1	Rating Watch Developing	Maintained
30-Apr-2020	A	A-1	Rating Watch Negative	Maintained
14-May-2019	A	A-1	Stable	Reaffirmed
27-Apr-2018	A	A-1	Stable	Reaffirmed
30-Oct-2017	A	A-1	Stable	Reaffirmed
03-May-2017	A	A-1	Stable	Reaffirmed
28-Oct-16	A	A-1	Stable	Upgrade
		RATING TYPE: INSTRUMENT		
27-Apr-2018	A			Reaffirmed
30-Oct-2017	A			Reaffirmed
03-May-17	A		Stable	Reaffirmed
28-Oct-16	A		Stable	Upgrade
21-Sep-16	A-		Stable	Final
14-June-16	A-		Stable	Preliminary

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. Asif Mahmood	Head Finance	March 14, 2023