The Pakistan Credit Rating Agency Limited

Rating Report

Telenor Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Nov-2018	A+	A1	Stable	Maintain	YES
27-Apr-2018	A+	A1	Stable	Maintain	-
23-Nov-2017	A+	A1	Stable	Maintain	-
28-Apr-2017	A+	A1	Stable	Maintain	-
28-Apr-2016	A+	A1	Rating Watch	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings take comfort from association with a strong sponsor – Telenor Group. The bank's business profile emanates from its growing customer base and sustained relative position. Securing an ~19% share in the MFB's gross loan portfolio (GLP) and ~21% in its gross deposits, the bank continues to hold a prominent position in the MFBs market. Significant developments in branchless banking (BB) are underway, including insistent steps to enhance the BB Mobile-wallet customer base. The bank is all geared up to undergo induction of ~45% stake by Ant Financial - a Chinese Fintech affiliate company of the Alibaba Group. The transaction is expected to be completed in three tranches, wherein, first tranche would be injected by End-November-18. Net interest/markup revenue (NIMR) increased during the period but the bank's bottomline closed in red due to high marketing OPEX incurred in pursuit of expanding BB customer outreach. Core banking indicators remained sanguine while BB domain continued to generate losses. The bank's business model is presently pivoted around developing a sustainable widespread M-wallet customer platform, with regards to which substantial results have been achieved. Liquidity profile reflects a comfortable outlook. Asset quality, however, slightly decreased (~1.7% infection ratio), mainly on the backdrop of unsecured lending. Currently. the management's paramount focus lies in taking a boom in the BB segment with respect to which entry of a new equity partner is a salient feature.

The ratings are dependent upon successful strategic alliance with Ant-Financial and achievement of positive indicators in the BB domain. Meanwhile, simultaneous growth trends in the core and BB domain remain imperative.

Disclosure	
Name of Rated Entity	Telenor Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18),Methodology | MFI (Jun-18)
Related Research	Sector Study | Microfinance Bank(Apr-18)
Rating Analysts	Nadeem Sheikh | nadeem.sheikh@pacra.com | +92-42-35869504

Profile

Structure Telenor Microfinance Bank Limited (hereinafter referred to as "the bank") was incorporated with the Securities and Exchange Commission of Pakistan on 1st August 2005, under section 32 of the Companies Ordinance, 1984 (now Companies Act, 2017). The Head office of the bank is located in Central Commercial Area, Karachi.

Background Telenor Microfinance Bank is a wholly owned subsidiary of Telenor Pakistan B.V. In 2016, Telenor Pakistan B.V acquired the bank wholly by way of acquisition of remaining ~49% from Telenor Pakistan (Private) Limited.

Operations The bank operates through a nationwide network of 86 branches in the low-income areas within Pakistan offering a diversified range of lending and insurance products. The bank also offers branchless banking services to its clients through its flagship product "Easy Paisa".

Ownership

Ownership Structure The bank is a wholly owned subsidiary of Telenor Pakistan B.V which is a joint stock company based in Amsterdam, being a subsidiary of Telenor ASA-Norwegian multinational telecommunications company. Ant-Financial, an affiliate fintech company of the Chinese Ali Baba group, is in process of acquiring ~45% stake in the bank in three tranches at a cost of $184.5mln, wherein, first tranche would be injected by End-November-18.

Stability The ownership structure of the bank is considered stable, which is expected to change, going forward, as Ant-Financial enters into the business.

Business Acumen Telenor ASA, the parent company of the Telenor Group is subsidiary of the Government of Norway. It is one of the world's major mobile operators headquartered in Oslo, Norway, with mobile operations spread across 13 countries. It has strong footprint in Europe and Asia. Telenor MFB, has also demonstrated to be one of the leading market players on a timeline basis, representing a strong business acumen.

Financial Strength Financial muscle of the sponsors is robust. Telenor ASA is listed on the Oslo stock exchange and has total assets amounting to USD~23bln at End-June'18 (End-Dec'17: USD~24bln).

Governance

Board Structure The overall control of the bank vests in nine member board of directors (BOD). The board comprises of the President/CEO, Mr. Shahid Mustafa and Chairman Mr. Petter Borre Furberg, six directors and one independent director.

Members' Profile The board members carry extensive experience in the telecom industry and financial services.

Board Effectiveness Attendance of Board of Directors during the meetings was good.

Financial Transparency KPMG Taseer Hadi & Co. Chartered Accountants are the External Auditors of the bank.

Management

Organizational Structure In line with bank's increased scale of operations, the organizational structure has evolved in order to take up the pace of expansion. Telenor MFB's operations are grouped under eleven departments with each Department Head reporting directly to the CEO and the head of internal audit reporting to the Audit Committee.

Management Team Mr. Shahid Mustafa – the President and CEO – carries over ~20 years of experience in banking and finance, and has been with the group for long. He formerly served as the CEO of Pakistan Microfinance Investment Company (PMIC). He is assisted by an experienced management team.

Effectiveness An Executive Committee is in place which comprises the CFO, CPO (Chief People's Officer), CRO (Chief Risk Officer) and the COO that report directly to the CEO. Asset liability committee is also in place.

MIS Detailed MIS reports are generated to support the senior management in timely and effective decision making. Daily MIS includes reports pertaining to disbursements, repayments, recoveries and deposits, separately for core and branchless banking operations.

Risk Management Framework Telenor Microfinance Bank has an established Risk Division Unit in place to oversee associated risks. The bank has developed and deployed a credit policy manual, which comprises guidelines for risk management framework.

Technology Infrastructure The bank's technological infrastructure is robust owing to increased need of advanced technology to remain competent in the branchless banking domain after the transfer of Easypaisa platform to the bank in CY17.

Business Risk

Industry Dynamics Pakistan Microfinance Industry comprises of 44 microfinance providers including 11 Microfinance Banks (MFBs), 17 Microfinance Institutions (MFIs), 7 Rural Support Program (RSPs) and 9 others projects. MFBs dominate the industry with a share in lending portfolio of ~68%.

Relative Position Telenor Microfinance Bank holds ~19% of the total gross loan portfolio of the MFBs industry, and has ~21% share in terms of active borrowers, thus making itself a significant MFB player. With a presence of 11 players in the market, Telenor Microfinance Bank has a significant share in the total amount of deposits, standing at ~21% at End-June 18, marginal increase from CY17 (~20%).

Revenue During the period under review, the bank's total operating income decreased to PKR~2,518mln with a decline of ~31% on YOY basis (1HCY17: PKR~3,664 mln). The loss is mainly attributed by high marketing OPEX in branchless banking division.

Profitability During 1HCY18, the earning assets of the bank reported at ~72% of the total assets as compared to ~83% of the total asset base of the bank in CY17. Total earning assets recorded at PKR~40.3bln as at End-June'18 (End-Dec'17: PKR~39.0bln). Profitability dwindled as the management's principal focus lied in enhancing its digital banking outreach for which it incurred aggressive marketing OPEX. Net Income/Markup revenue (NIMR) for 1HCY18 clocked in at PKR~2,787mln (1HCY17: PKR~1,976mln), core banking indicators reflected a net gain of PKR~350mln while branchless banking's loss hiked to PKR~679mln (CY17:PKR~421mln).

Sustainability During the period under review the bank performance indicator has been impaired. Return on equity entered into negative zone as the bank made losses during the period. However, strong competitive position persists for the bank; as the future strategic partnership with Ant-Financial is expected to bring significant changes to the overall business profile of the bank. However, out-turn of the transaction and its impact on the bank's governance, operations, financial systems and performance is yet to roll-out.

Financial Risk

Credit Risk Multi-tier credit approval process is in place that has the necessary checks and independent verification required to critically assess credit risk. Despite stringent credit control mechanism, including introduction of underwriting technique since the beginning of CY17, the asset infection ratio increased slightly during the period under review and was recorded at ~1.7% at End-June'18 as compared to ~1% at End-Dec'17.

Market Risk The bank's investment portfolio constitutes ~13% of bank's total assets at End-June18 (End-Dec17: ~14%). Investments solely comprised of Market Treasury Bills, which limits market risk and will provide likely hedge against interest rate volatility along with liquidity support to the bank.

Funding The Bank's external funding solely constitutes deposits clocking in at PKR~43,874mln at End-June'18 (End-Dec'17: PKR~36,665mln). Deposits during the period ending June-18 grew by ~20%. Branchless banking side of the bank is growing as the deposits from the segment increased by ~24% during the period under review.

Liquidity Liquidity profile improved during the period under review as the bank's liquid assets-to-deposits and borrowings ratio increased to ~46% at End-June'18 (End-Dec'17: ~43%).

Capital Adequacy During the period under review, sponsors injected a total equity of PKR~1,470mln. The bank's capital adequacy ratio (CAR) however, still dropped to ~18% at End-June'18 (End-Dec'17:~20%), mainly on the backdrop of net losses for the period and unsecured lending.

Telenor MicroFinance Bank Limited

PKR mln

BALANCE SHEET	30-Jun-18	31-Dec-17	31-Dec-16	31-Dec-15
Earning Assets				
Advances	29,895	24,746	15,851	12,130
Investments (Government Securities)	7,507	6,767	11,568	3,784
Deposits with Banks	2,900	4,139	2,551	1,103
Lending to Financial Institutions	-	3,368	323	347
	40,302	**39,020**	**30,293**	**17,364**
Non Earning Assets				
Non-Earning Cash	9,584	3,514	3,125	1,603
Net Non-Performing Finances	169	16	(15)	(4)
Fixed Assets & Others	5,831	4,578	2,901	2,094
	15,583	**8,108**	**6,011**	**3,694**
TOTAL ASSETS	**55,885**	**47,128**	**36,304**	**21,058**
Interest Bearing Liabilities				
Deposits	**43,874**	**36,665**	**27,830**	**15,679**
Branch Banking	32,168	27,225	23,851	10,183
Branchless Banking	11,706	9,440	3,979	5,495
Borrowings	-	-	-	85
	43,874	36,665	27,830	15,764
Non Interest Bearing Liabilities	5,846	5,457	3,888	1,605
TOTAL LIABILITIES	**49,721**	**42,122**	**31,718**	**17,369**
EQUITY (including revaluation surplus)	6,119	4,981	4,576	3,657
Deferred Grants	46	25	10	31
Total Liabilities & Equity	**55,885**	**47,128**	**36,304**	**21,057**

INCOME STATEMENT	30-Jun-18	31-Dec-17	31-Dec-16	31-Dec-15
Interest / Mark up Earned	3,964	6,064	4,487	3,503
Interest / Mark up Expensed	(1,177)	(1,767)	(1,113)	(663)
Net Interest / Markup revenue	**2,787**	**4,297**	**3,373**	**2,840**
Direct Branchless Banking pre-tax profits	(679)	(421)	63	(9)
Other Operating Income	430	712	560	350
Total Revenue	**2,538**	**4,588**	**3,997**	**3,182**
Other Income	-	-	-	167
Non-Interest / Non-Mark up Expensed	(2,595)	(3,629)	(2,486)	(1,987)
Pre-provision operating profit	(57)	959	1,511	1,362
Provisions	(236)	(271)	(141)	(80)
Pre-tax profit	(293)	687	1,370	1,282
Taxes	(36)	(271)	(474)	(431)
Net Income	**(329)**	**417**	**896**	**852**

Ratio Analysis	30-Jun-18	31-Dec-17	31-Dec-16	31-Dec-15
Performance				
ROE	-12%	9%	22%	26%
Cost-to-Total Net Revenue	101%	93%	70%	72%
Provision Expense / Pre Provision Profit	-412%	28%	9%	6%
Capital Adequacy				
Equity/Total Assets	11%	11%	13%	17%
Capital Adequacy Ratio as per SBP	18%	20%	31%	39%
Loan Loss Coverage				
Non-Performing Advances /Gross Advances	2%	1%	1%	0%
Loan Loss Provisions / Non-Performing Advances	67%	94%	116%	106%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	46%	43%	63%	43%
Advances / Deposits	69%	68%	57%	77%
CASA deposits / Total Customer Deposits	52%	51%	53%	71%
Intermediation Efficiency				
Asset Yield	20%	17%	19%	21%
Cost of Funds	6%	5%	5%	4%
Spread	14%	12%	14%	17%
Outreach				
Branches	86	85	74	66

Rating Scale

Credit Rating Scale & Definitions

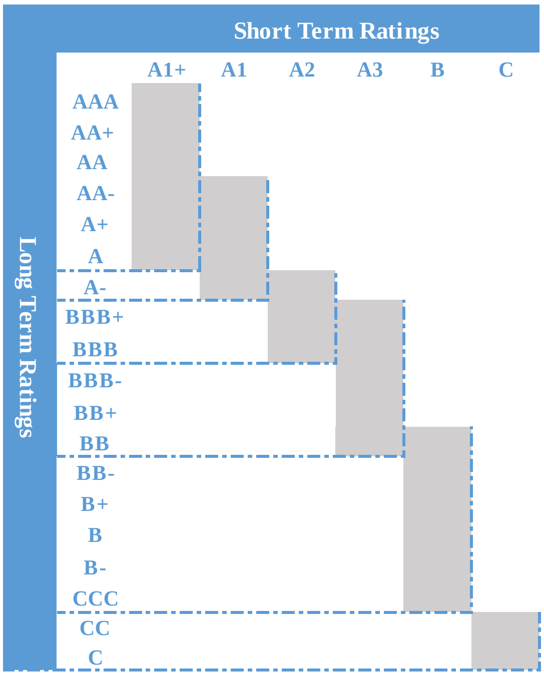
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

Rating	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

Rating	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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Conduct of Business
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(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
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(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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