The Pakistan Credit Rating Agency Limited

Rating Report

NRSP Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
14-Dec-2022	A-	A2	Negative	Downgrade	Yes
29-Apr-2022	A	A1	Negative	Maintain	Yes
30-Apr-2021	A	A1	Stable	Maintain	Yes
23-Oct-2020	A	A1	Stable	Maintain	Yes
27-Apr-2020	A	A1	Negative	Maintain	Yes
28-Oct-2019	A	A1	Negative	Maintain	-
29-Apr-2019	A	A1	Negative	Maintain	-
06-Nov-2018	A	A1	Stable	Maintain	-
30-Apr-2018	A	A1	Stable	Maintain	-
31-Oct-2017	A	A1	Stable	Maintain	-
29-Apr-2017	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

NRSP Bank's asset quality witnessed significant impairment. This was due to multiple factors, chief among them was the impact of Covid-19 and the high inflationary environment amidst a slowdown in the economy and high-interest rates. Only recently, the massive floods took a deep toll. This resulted in the erosion of the bank's capital adequacy ratio, which the bank is required to maintain at 15%. The deferred book to total GLP was sizeable. Further challenges in recovery and markup suspension led to decreased markup earned. Consequently, the bank booked a loss at the net mark-up level at end-Sep-2022 (PKR 907mln). Provisioning impact (PKR 1.7bln) took a further toll. Although the administrative expenses were maintained in the nine months, the red net markup loss after the provision dominated the entire profit and loss account for the period that ended September 30, 2022. The bank booked a loss after tax of PKR 2.5bln for the above-mentioned period. As a result, the equity of the bank reduced from PKR 4.2bln at end-Sep 2021 to PKR 1.7bln at end-Sep 2022. The cash and bank balances have fallen, though there is a slight reduction in borrowings as well. The impact is seen in the reduced deposit base. Holding the deposit base and also liquidity position is highly important. To cover up the losses and improve its CAR, the bank is seeking equity support from the sponsor shareholder: National Rural Support Programme. NRSP Board of Directors, as on May 12, 2022, approved an investment of up to PKR 2bln into the equity of the bank. It was well noted and comfort was drawn from this. The equity injection would help the bank to continue its operations, unabated. There is a high need that the process for the above injection to be harnessed.

The ratings are dependent upon the bank’s ability to steer out of the current challenges while improving the risk profile. The equity base needs to be enhanced while augmenting the CAR. The process of rights issue needs to be carried out on a war footing. Recovery from bad loans is also important. Any non-compliance with the regulatory or contractual obligations would be negative for the ratings.

Disclosure

Name of Rated Entity	NRSP Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Microfinance Institution Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Microfinance(Sep-22)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure NRSP Microfinance Bank Limited ('The Bank') was incorporated as a public unlisted company in October 2008 under Section 32 of the Companies Ordinance, 1984 (now the Companies Act, 2017). The bank commenced nationwide operations in March 2011.

Background The Bank builds on the experience of its parent institution - National Rural Support Program (NRSP) which in 2008, spun-off its Micro Enterprise Development Programme (MEDP) into a separate bank.

Operations The Bank currently operates with its head office in Bahawalpur, a key district in Southern Pun-jab, which places it closer to its target market. The Bank is operational through a countrywide branch network of 150 branches including 42 Islamic branches as of Dec 31, 2021. A wide range of financial services is offered by the bank including micro-lending, micro-insurance, Is-lamic banking products, and deposits to the financially excluded individuals living in both ur-ban and rural areas of Pakistan.

Ownership

Ownership Structure The Bank is a subsidiary of the National Rural Support Program (NRSP) with a shareholding of 57.40%. Other institutional shareholders include International Finance Corporation (IFC) (16.02%), PROPARCO (15.91%), and Acumen (10.68%).

Stability Continued sponsor support accompanied by a stable ownership pattern, since inception, bodes well for the bank.

Business Acumen NRSP – a nonprofit organization – established in 1991, is an autonomous body limited by a government guarantee. It is the largest Rural Support Program in the country in terms of out-reach, staff, and development activities. Other sponsors including; IFC - a member of the World Bank Group and Acumen - incorporated in 2001, share the common purpose to develop underprivileged societies of developing economies and encourage financial inclusion.

Financial Strength Good financial position of sponsors strengthens the financial muscle of the bank.

Governance

Board Structure The overall control of the Bank vests in a seven-member board of directors (BOD), including the CEO. The Chairman of the Board is Mr. Rashid Bajwa and Mr. Zahoor Hussain Khan is the CEO/President of the bank. One independent director is part of the Board.

Members' Profile The directors are experienced professionals having exposure in various sectors, including the microfinance industry.

Board Effectiveness The Board of directors is branched into three sub-committees namely (i) Audit (ii) Remuneration & Compensation and (iii) Operational Risk and Policy. These committees ensure effective over-sight of the bank's affairs and strengthen the Board's governance role.

Transparency M/S A.F. Ferguson & Co. are the external auditors of the bank. The auditor has expressed a quali-fied conclusion on the financial statements of 6MCY22 due to undercharging of provisions.

Management

Organizational Structure The bank has divided its organizational structure into ten departments with each department head reporting directly to the CEO, while the head of the internal audit department reports to the Audit Committee.

Management Team Mr. Zahoor Hussain Khan – the President and CEO – carries over 23 years of experience in banking and finance and has been associated with the group for a long. The CEO is assisted by an experienced management team.

Effectiveness To ensure the effectiveness of the operations, the bank has three management committees in place, namely; i) Operations and Risk Management Committee (ORMC), ii) Asset Liability Committee (ALCO) and iii) IT Steering Committee.

MIS Detailed MIS reports are generated to support the senior management in timely and effective decision-making. MIS includes reports about disbursements, repayments, recoveries, deposits, and compliance.

Risk Management Framework The bank has instituted policies for assessing credit worthiness of loan applicants, which is par-amount to its business model. Recently, the bank has particularly steered its focus toward consolidating its position by adopting more stringent and efficient risk control mechanisms.

Technology Infrastructure The bank uses Oracle Flexcube as its core banking software; implemented since 2012. A back-to-back support contract from Oracle is directly in place to ensure a smooth system run.

Business Risk

Industry Dynamics Pakistan Microfinance Industry (MFI) comprises 50 microfinance providers including 30 micro-finance institutions (MFIs). Active Borrowers continued the increasing trend as 8.5 million borrowers were achieved during CY22, an increase of 5.6% compared to CY21. Similarly, the GLP surpassed PKR 448bln during CY22, an increase of 26.1% compared to the GLP in CY21. The further analysis explains the major contribution to the growth of active borrowers and GLP was contributed by the MFB peer group where Mobilink MFB was at the top of the list due to the significant adoption of digital credit and greater outreach to the customer base. NBMFCs peer group also contributed to the increase by adding 94,000 active borrowers and PKR 2.6bln in GLP. In the case of MFBs, PAR > 30 days slightly increased to 5.3% (CY21: 5.2%). Howev-er, the PAR > 30 days of MFIs recovered to report at 4.1% in CY22 (CY21: 5.5%).

Relative Position The bank catered to 3.3% of the borrowers in the microfinance industry (including MFIs, RSPs, and other projects) as at end-Jun'22, grabbing a 7.1% share of the market in terms of Gross Loan Portfolio (GLP).

Revenue The interest/Mark up income of the Bank decreased by 63.2% to PKR 1,987mln during 9MCY22 (9MCY21: PKR 5,401mln). Consequently, net interest income also witnessed a decline to report a loss of PKR 907mln (Profit in 9MCY21: PKR 2,508).

Profitability During 9MCY22, the bank's net profitability decreased manifold to report a loss of PKR 2,525mln (9MCY21: PKR 952mln). This was due to higher markup and non-markup expenses and a decline in markup earned.

Sustainability The microfinance industry has notably absorbed the effect of macroeconomic instabilities in its portfolio in the shape of slumped growth and elevated Portfolio at Risk (PAR). NRSP MFBs, in terms of affect absorption, have been on the higher end, due to their product mix concentration and other factors.

Financial Risk

Credit Risk The bank's loan book is primarily concentrated on non-collateralized loans. As at end-Sep'22, the GLP witnessed a 7.9% decline to report at PKR 26,450mln (end-Dec'21: PKR 28,726mln). Advances continued to be dominated by Agri Input Loans, followed by Micro-Enterprise Loans and Livestock Loans. The bank's infection ratio rose to ~20% (End-Dec'21: ~7%), mainly as a result of increasing NPLs to PKR 6,551mln (End-Dec'21: PKR 2,122mln).

Market Risk As at end-Sep'22, the Bank's investment book decreased by 60.4% to PKR 2,685mln (End-Dec'21: PKR 6,782mln).

Funding The bank's funding is majorly fuelled through deposits, which primarily consist of time deposits (56.2%).

Cashflows & Coverages Liquidity profile impaired during 9MCY21 as the bank's liquid assets to deposits and short-term borrowings ratio declined to 21.1% (End-Dec'21: 47.5%). The bank regularly monitors its liquidity through its Asset and Liability Management Committee (ALCO).

Capital Adequacy The central bank required microfinance banks to maintain CAR at a minimum of 15%. As at end-Sep'22, the bank is CAR non-compliant.

PKR mln

NRSP Microfinance Bank Public Limited	Sep-22	Dec-21	Dec-20	Dec-19
	9M	12M	12M	12M
A BALANCE SHEET				
1 Total Finances - net	26,450	28,726	28,048	27,610
2 Investments	2,685	6,782	8,638	1,440
3 Other Earning Assets	1,819	7,703	7,320	3,946
4 Non-Earning Assets	8,243	9,717	9,271	6,957
5 Non-Performing Finances-net	3,751	(1,547)	(115)	52
Total Assets	42,948	51,381	53,161	40,005
6 Deposits	29,086	34,127	39,285	26,651
7 Borrowings	7,182	8,378	4,068	4,484
8 Other Liabilities (Non-Interest Bearing)	4,930	4,597	4,298	4,183
Total Liabilities	41,199	47,102	47,651	35,318
Equity	1,747	4,274	5,498	4,684
B INCOME STATEMENT				
1 Mark Up Earned	1,987	7,989	8,852	7,524
2 Mark Up Expensed	(2,894)	(3,790)	(3,929)	(3,402)
3 Non Mark Up Income	1,359	1,086	1,077	1,165
Total Income	452	5,286	6,000	5,287
4 Non-Mark Up Expenses	(2,367)	(3,160)	(3,115)	(3,355)
5 Provisions/Write offs/Reversals	(1,724)	(3,988)	(1,741)	(1,845)
Pre-Tax Profit	(3,639)	(1,862)	1,144	87
6 Taxes	1,114	631	(351)	(3)
Profit After Tax	(2,525)	(1,232)	793	84
C RATIO ANALYSIS				
1 Performance				
Portfolio Yield	8.9%	24.8%	31.1%	31.8%
Minimum Lending Rate	29.1%	36.3%	30.7%	33.1%
Operational Self Sufficiency (OSS)	47.9%	83.0%	113.0%	101.0%
Return on Equity	-111.7%	-25.2%	15.6%	1.8%
2 Capital Adequacy				
Net NPL/Equity	214.5%	-36.2%	-2.1%	1.1%
Equity / Total Assets (D+E+F)	4.1%	8.3%	10.3%	11.7%
Capital Formation Rate [(Profit After Tax - Cash Dividend) / Equity]	-78.8%	-22.4%	16.9%	1.8%
3 Funding & Liquidity				
Liquid Assets as a % of Deposits & Short term Borrowings	21.1%	47.5%	41.8%	25.9%
Demand Deposit Coverage Ratio	185.2%	461.0%	562.4%	303.2%
Funding Diversification (Deposits/(Deposits+Borrowings+Grants))	80.2%	80.3%	90.6%	85.6%
Net Advances to Deposits Ratio	103.8%	79.6%	71.1%	103.8%
4 Credit Risk				
PAR 30 Ratio	19.8%	6.9%	4.2%	1.6%
True Infection Ratio	19.8%	6.9%	4.2%	1.6%
Risk Coverage Ratio (PAR 30)	42.7%	172.9%	109.3%	88.4%

Credit Rating

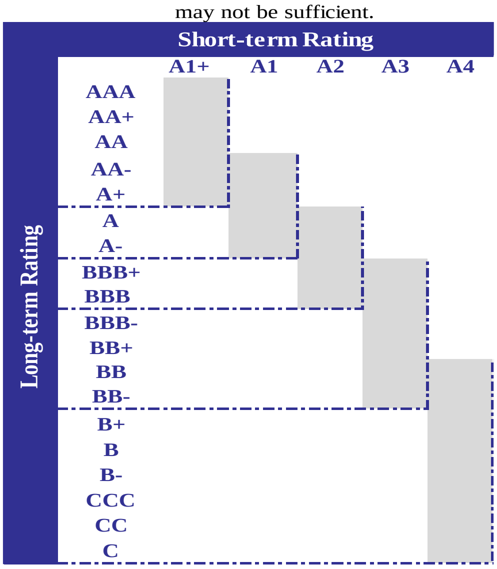
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	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 Rating

Scale	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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(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 | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(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)

Proprietary Information