The Pakistan Credit Rating Agency Limited

Rating Report

Sindh Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Mar-2022	A-	A2	Stable	Maintain	-
09-Apr-2021	A-	A2	Stable	Maintain	Yes
30-Apr-2020	A-	A2	Stable	Maintain	Yes
30-Sep-2019	A-	A2	Stable	Maintain	-
18-Apr-2019	A-	A2	Stable	Maintain	-
17-Oct-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings capture the aptness of the Bank as a growing institution in the microfinance sector. The Bank's business model incorporates appropriate mitigant controls to keep its risk profile adequate. Reasoning with the market conditions, asset infection ratio stood at ~1% as at end-Dec'21. The net profitability of the bank has diluted in CY21 (CY21: PKR 27mln; CY20: PKR 53mln). The primary factor behind the dip is the shortfall in disbursements (over few months). Afterwards, rise in GLP was recorded (CY21: PKR 920mln; CY20: PKR 525mln), therefore it is expected that the Bank will be able to improve the similar growth trajectory in profitability. The design of the lending portfolio represents concentration in the flagship product "Sujag Aurat" (Visionary Women), focused on women entrepreneurship and financial inclusion. The Bank's funding needs are currently being fueled through a mixture of internal and external sources. A major share of the funding has been obtained from State Bank of Pakistan on a partially low cost. Whereas, deposit mobilization has also shown slight rise during CY21. The Bank has presence in Sindh with plans to go national. As the equity of SMFB is expected to cross PKR 1bln this year and with that the Bank will be able to apply for a National Level License in CY23. A risk-averse approach towards expansion is the key essential, with funds being raised with a cautious approach. The ratings draw comfort from the Bank's association with the Government of Sindh. The financial risk profile is reflected by sanguine liquidity, adequate profitability and low investment in non-earning assets.

The ratings are dependent upon the bank’s ability to aptly combat the emerging risks under the current scenario in order to keep its business and financial risk profile intact.

Disclosure

Name of Rated Entity	Sindh Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Microfinance Institution Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Microfinance(Sep-21)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure Sindh Microfinance Bank Limited was incorporated with the Securities and Exchange Commission of Pakistan on March 27, 2015 under Section 32 of the Companies Ordinance, 1984 (now Companies Act, 2017).

Background The Bank was established as a wholly owned subsidiary of Sindh Bank Limited and got license to operate as a Microfinance Bank (MFB) from the State Bank of Pakistan (SBP) on October 16, 2015.

Operations The Bank currently operates in the province of Sindh with a network of 18 branches and 62 micro-credit centers. Lending portfolio of the bank is concentrated in its flagship product “Sujag Aurat” (Visionary Women) which is a product exclusively designed for women empowerment. Other products include fisheries, individuals, agriculture, gold and livestock loans. The Head office of the Bank is located in Muhammad Ali Cooperative Housing Society, Karachi.

Ownership

Ownership Structure The Bank is a wholly owned subsidiary of Sindh Bank Limited (the Holding Bank), which is owned by the Government of Sindh through its finance department.

Stability The bank's ownership structure indicates clarity and stability. However, in the foreseeable future the bank may receive an equity stake from international investor where due diligence is under process.

Business Acumen The Bank was incorporated as part of the Government of Sindh's initiative to step into the financial sector, for its betterment and growth. Apart from Sindh Bank and Sindh MFB, other entities of the project include Sindh Leasing, Sindh Modaraba and Sindh Insurance. Sindh Bank has a network of over 330 branches and presence in 169 cities across Pakistan.

Financial Strength Sponsor financial muscle is considered robust. Sindh Bank’s equity as at end-Sep,2021 stood at PKR 17.5bln and its gross advances were recorded at PKR 52.8bln.

Governance

Board Structure The overall control of the Bank vests in seven-member board of directors (BOD) including the President/ CEO. There are five sub-committees on the board.

Members’ Profile The board members are cherished with extensive experience in financial and banking services.

Board Effectiveness Attendance of Board of directors during the meetings was good and minutes are properly documented.

Transparency Naveed Zafar Ashfaq Jaffery & Co., Chartered Accountants are the External Auditors of the Bank. They expressed an unqualified opinion on the financial statements for the year ended December, 2021.

Management

Organizational Structure The Bank’s structure is divided into different departments. All department heads report directly to CEO and head of internal audit reports directly to Audit Committee. The Bank’s functions are distributed among head office, branches and micro-credit centers (also known as financial centers).

Management Team The management team is led by the CEO - Mr. Shoaib Arif. He is a seasoned microfinance practitioner having an experience of over two decades. Prior to Sindh Microfinance Bank Limited, he served as the COO at ASA Pakistan Limited and CEO at ASA Kabul-Afghanistan. The CEO is assisted by experienced management team. Most of them are associated with microfinance industry for more than a decade.

Effectiveness The Bank has a systematic decision making process. Multiple management committees are formed to monitor performance and ensure adherence to policies and procedures.

MIS The Bank’s core banking software is low in cost and high in quality, it offers advance technology and high availability on both centralized and distributed environments and is highly secure.

Risk Management Framework The Bank is progressing through its initial years with a well-managed risk control framework by implementation of procedures and limits at the root level of operational activities. This framework is enabling the management to succeed stably in achieving operational efficacy and growing the business size gradually.

Technology Infrastructure The Bank has installed PIBAS software as its core banking solution. The system offers different applications which includes security, centralized limits, reconciliations and others. It offers real time surveillance of branches and financial centers.

Business Risk

Industry Dynamics Pakistan Microfinance Industry (MFI) comprises of 50 microfinance providers including 30 microfinance institutions (MFIs). During CY21, active borrowers of the industry exceeded pre-COVID figure to 8.1 million borrowers after recording growth of 16% compared to CY20. Similarly, the GLP surpassed PKR 390 billion during CY21, an increase of 21% compared to CY20. The growth in active borrowers and GLP continues to be driven by the MFB peer group as they managed to add over one million clients and PKR 52 billion in GLP. NBMFC peer group also contributed to portfolio growth with an addition of PKR 16.7 billion. In case of MFBs, PAR > 30 days increased to 5.1% (CY20: 3.3%) on account of expiration of loan deferment period allowed by SBP. However, the PAR > 30 days of MFIs recovered to report at 2.9% in CY21 (CY20: 4.7%).

Relative Position The Bank currently holds very small market share in terms of GLP but it is rapidly growing and looking forward to enhance its lending portfolio in upcoming years. After the planned equity injection, the bank will apply for license to operate at National Level.

Revenue The Bank’s mark-up earned decreased to PKR 345mln in CY21 (CY20: PKR 362mln), down by 4.7% owing to decrease in income from investments by 23.3% on YoY basis. Whereas, the Bank witnessed a increased of 5% in mark-up earned on advances mainly driven by the high growth in loan portfolio. However, the Bank’s portfolio yield witnessed marginal decline (CY21: 34.7% ; CY20: 35.2%).

Profitability Net mark up income remained largely intact at PKR 284mln (CY20: PKR 283mln). Rise in non-markup expenses of 12.6% were recorded and the same stood at PKR 223mln (CY20: PKR 198mln). This is mainly due to significant increase in administrative expenses as the Bank has recently opened a new branch and six micro-credit centers. The Bank recorded a provision of PKR 15mln (CY20: PKR 14mln) & taxes reported as (CY21: PKR 18mln; CY20: PKR 17mln), translated in to a PAT of PKR 27mln (CY20: PKR 53mln).

Sustainability Going forward the Bank will focus to increase its loan portfolio, with a cautious approach. Other than that Sindh's management has a growth-centric approach through market penetration by way of expansion. Management has a devised plan to achieve its objectives in the medium term.

Financial Risk

Credit Risk During CY21, Sindh MFB's gross micro-credit advances reported a rise of 75.23% on YoY basis (CY21: PKR 920mln ; CY20: PKR 525mln). Hence, the Bank reclaimed its previous growth trajectory. The Bank's credit portfolio is concentrated to its single product " Sujag Aurat Loan" (CY21: 83.4%; CY20: 91.5%). Infection increased to PKR 11mln (CY20: PKR 5mln). However, coverage ratio remains strong attributable to cushion in provisioning available.

Market Risk The Bank's investments in government securities witnessed a rise during CY21 (CY21: PKR 26mln; CY20: PKR 13mln), exposure lies within T-bills. Therefore, Bank's exposure to market risk remains low.

Funding Funding base comprise of deposits and borrowings. The deposit base recorded notable improvement to PKR 271mln (end-Dec20: PKR 139mln). During CY21, the Bank obtained borrowing from the SBP under the Line of Credit Scheme, total amounting to PKR 750mln (CY20: PKR 750mln). The cost of the line is partially reduced with interest being paid bi-annually and principal can be paid within five years by 2024. Total borrowing stand at PKR 750mln (end-Dec20: PKR 750mln).

Cashflows & Coverages During CY21, Sindh MFB’s Individual deposits increased to PKR 21mln (CY20: PKR 19mln), similarly institutional deposits also increased to PKR 250mln (CY20: PKR 120mln).

Capital Adequacy As the Bank is establishing its loan book, its capital adequacy ratio (CAR) stood at 73.3% as at end-Dec21.

Sindh Microfinance Bank Limited Un-listed Public Limited	Dec-21 12M	Dec-20 12M	Dec-19 12M
A BALANCE SHEET			
1 Total Finances - net	920	525	830
2 Investments	26	13	19
3 Other Earning Assets	894	1,142	934
4 Non-Earning Assets	248	220	123
5 Non-Performing Finances-net	(3)	(1)	2
Total Assets	2,085	1,899	1,908
6 Deposits	271	139	126
7 Borrowings	750	750	800
8 Other Liabilities (Non-Interest Bearing)	95	67	91
Total Liabilities	1,116	956	1,018
Equity	969	943	890
B INCOME STATEMENT			
1 Mark Up Earned	345	362	347
2 Mark Up Expensed	(62)	(80)	(71)
3 Non Mark Up Income	-	-	-
Total Income	284	283	276
4 Non-Mark Up Expenses	(223)	(198)	(194)
5 Provisions/Write offs/Reversals	(15)	(14)	(13)
Pre-Tax Profit	45	70	69
6 Taxes	(18)	(17)	(16)
Profit After Tax	27	53	52
C RATIO ANALYSIS			
1 Performance			
Portfolio Yield	34.7%	35.2%	36.9%
Minimum Lending Rate	40.8%	42.2%	38.5%
Operational Self Sufficiency (OSS)	115.9%	124.6%	125.6%
Return on Equity	2.8%	5.8%	6.0%
2 Capital Adequacy			
Net NPL/Equity	-0.3%	-0.1%	0.2%
Equity / Total Assets (D+E+F)	46.5%	49.6%	46.6%
Tier I Capital / Risk Weighted Assets	71.8%	96.8%	75.4%
Capital Adequacy Ratio	73.3%	98.3%	76.8%
Capital Formation Rate [(Profit After Tax - Cash Dividend) / Equity]	2.8%	5.9%	6.2%
3 Funding & Liquidity			
Liquid Assets as a % of Deposits & Short term Borrowings	350.9%	850.8%	763.5%
Demand Deposit Coverage Ratio	380.2%	850.8%	763.5%
Liquid Assets/Top 20 Depositors	350.9%	852.9%	766.2%
Funding Diversification (Deposits/(Deposits+Borrowings+Grants))	26.5%	15.7%	13.6%
Net Advances to Deposits Ratio	338.5%	376.3%	657.7%
4 Credit Risk			
Top 20 Advances / Advances	0.3%	20.7%	11.8%
PAR 30 Ratio	1.1%	1.0%	2.0%
Write Off Ratio	0.0%	0.0%	0.0%
True Infection Ratio	1.1%	1.0%	2.0%

Credit Rating

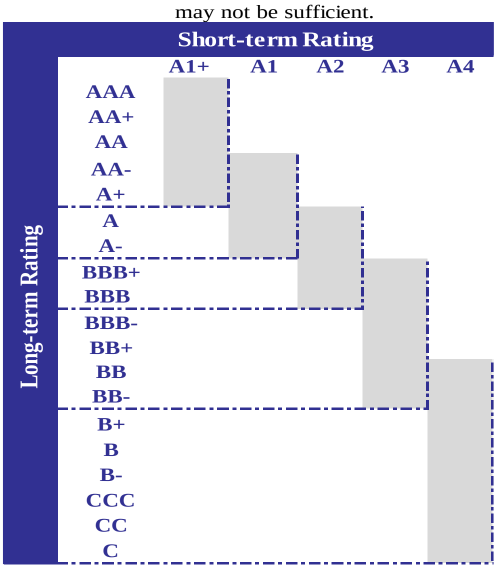
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.
(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