The Pakistan Credit Rating Agency Limited

Rating Report

U Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
16-Sep-2022	A+	A1	Stable	Upgrade	-
18-Aug-2021	A	A1	Stable	Maintain	Yes
18-Aug-2020	A	A1	Stable	Initial	Yes

Rating Rationale and Key Rating Drivers

The ratings reflect the association of U Microfinance Bank Limited (U Bank) with Pakistan Telecommunication Company Limited (PTCL), the country's leading Information and Communication Technology Service Provider. This affiliation supports the Bank in terms of building a strategic congruence alongside establishing robust systems and controls. U Bank is a fast-growing player in the Microfinance Sector. The Bank's ambitious growth strategy encompasses multi-faceted targets focused on achieving growth in the retail banking segment, and developing a digital banking platform. Going forward, the envisaged strategy encompass diversification at segmental, geographical, and product level. A sizeable book of GOP securities (end-June22: PKR 27.7bln) in the investment portfolio assisted in maintaining liquidity. The Bank's digital segment is yet to progress a long way to mark its presence in the competitive landscape; the mix is currently small. Almost half of the Bank’s portfolio is gold-backed. Asset quality was impaired, as deferred book to total GLP was significant. To build a cushion, the Bank has recognized a sizable subjective provision in order to add a further cushion for absorption of expected loan losses. This provides a strong mitigant against potential credit risk. The investment income stream has helped the bank to bolster its profitability through this avenue. SBP’s recent circular pertaining to further relaxation in recording provisioning expense of NPLs is expected to bring reversal. Sizable enhanced markup and non-markup income provide comfort. The Bank's funding needs are primarily fostered through a growing deposit base, coupled with sizable borrowings. The ratings are constrained by high concentration in deposit base; increased on account of gaining. The strengthening of the equity base over the last few years is a positive. The industry's few parameters are deteriorating on account of pressured macroeconomic indicators, attributable to the aftermath of the COVID-19 and recent flood situation. The relative impact on the risk profiles of industry players is yet to unfold in the days to come.

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. Stable outlook denotes comfort on business risk and financial risk profile of the bank.

Disclosure

Name of Rated Entity	U 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-21)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure U Microfinance Bank Limited ("U Bank" or "the Bank") was incorporated, under section 32 of the Companies Ordinance, 1984 (now Companies Act, 2017). The Bank was granted license by SBP for commencement of nationwide operations in 2013.

Background Rozgar Microfinance Bank Ltd was established in 2003, as a district wide microfinance bank, operating in Karachi. Pakistan Telecommunication Company Limited (PTCL) acquired 100% of its shareholding in 2012. Henceforth, its name was changed to U Microfinance Bank Limited.

Operations The Bank offers a wide range of microfinance loans, deposit products, and branchless banking solutions. It has a network of 208 branches, across 183 cities and rural areas in Pakistan, while the head office is situated in Islamabad. The Bank is also establishing its foothold in BB operations via its mobile wallet, U Paisa.

Ownership

Ownership Structure The Bank is a wholly-owned subsidiary of PTCL, which is co-owned by the Government of Pakistan (62%) and Etisalat International Pakistan (LLC) (26%) (Etisalat), a state-owned Telecom Corporation of UAE. Management control of PTCL rests with Etisalat.

Stability Stable ownership and sovereign support of the Government of Pakistan available in the parent company, complemented by the technical and financial prowess of a global tech giant, bodes well for the future stability of the Bank.

Business Acumen PTCL, the backbone for the country's telecommunication infrastructure, is the market leader in providing telephone and internet services nationwide. The Etisalat Group is one of the world's leading telecom groups, which operates in ~16 countries across the Middle East, Asia and Africa. The Group provides U Bank with international expertise and strategic direction through its presence on the Board.

Financial Strength PTCL has been assigned credit ratings of AAA/A-1+ by VIS. The sponsor's ability to support the Bank can be gauged, with substantial subordinated lending to the Bank. Etisalat Group enjoys credit ratings of AA-/Stable (Jun'20) and Aa3/Stable (Jun'20) by S&P Global and Moody's, respectively.

Governance

Board Structure The board of U Bank consists of eight directors, comprising representatives of Etisalat, PTCL, and Government of Pakistan.

Members' Profile All of the board members have international exposure and carry diversified expertise. Mr. Burak Sevilengul, the Chairman of the Board, has over 24 years of experience.

Board Effectiveness Attendance of board members in these meetings remained adequate. There are five board committees in place which help the board in effective oversight of the Bank's overall operations on relevant matters.

Transparency M/S KPMG Taseer Hadi & Co. Chartered Accountants, are the External Auditors of the Bank. An unqualified audit opinion was expressed on the financial statements for the year ended Dec'21. The internal audit department reports directly to the Audit Committee, ensuring independence.

Management

Organizational Structure U Bank has a horizontally spread organizational structure comprising nine departments. The reporting lines and job descriptions at each level are well defined.

Management Team Mr. Kabeer Naqvi, the President & CEO, has 20 years of professional experience to his name. A team of professionals assist him.

Effectiveness The Bank has formed various committees at the management level for effective and smooth functioning of each business segment.

MIS The Bank has deployed PIBAS for handling the core banking operations which has Visual Basic at the front-end whereas the back-end is Oracle based. The other IT platform is SYBASE-365, for the BB segment. It is a financial services platform which provides an end-to-end solution for mobile commerce businesses.

Risk Management Framework The Risk Management Committee exists to ensure the risk profile of the Bank remains within the check. A risk management manual contains guidelines to help management in improving the internal control environment. A Disaster Recovery site is in place in Lahore, located alongside the PTCL data center.

Technology Infrastructure The management aims to scale up the IT infrastructure for future business growth and network expansion. Building on the synergies with Ufone, has a technological platform, to facilitate BB operations (UPaisa), utility payments, ATM service and G2P payments.

Business Risk

Industry Dynamics Pakistan Microfinance Industry (MFI) comprises 50 microfinance providers including 30 microfinance institutions (MFIs). During CY21, active borrowers of the industry exceeded the pre-COVID figure to 8.1 million borrowers after recording a 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 the case of MFBs, PAR > 30 days increased to 5.1% (CY20: 3.3%) on account of the expiration of the 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 grabbing a 12.9% market share in terms of GLP as of end-Sep21.

Revenue During CY21, income on advances increased to PKR 10.0bln (CY20: PKR 9.0bln) whereas, on the investment side, gross markup increased to PKR 2.1bln (CY20: PKR 1.0bln). Non-mark up income to total income decreased to 16.2% (end-Dec20: 17.9%). During 1HCY22, markup earned was recorded at PKR 8.4bln (1HCY21: PKR 5.7bln). Non mark up income of the bank was enhanced to PKR 793mln (1HCY21: PKR 593mln) attributable to improved fee and commission income along with other income. Asset yield moved to 17.6% (CY21: 16.7%).

Profitability The total income of the bank, during 1HCY22, improved to PKR 4bln (1HCY21: PKR 3.7bln). The Bank's non-mark-up expenses increased to PKR 3.0bln (1HCY21: PKR 2.4bln) where administration expenses recorded an uptick. Profit before tax of the Bank witnessed a sizable growth and was reported at PKR 761mln (1HCY21: PKR 825mln).

Sustainability Going forward, U Bank's key focus would be to enhance its lending book mainly through micro credit while diversifying its product base.

Financial Risk

Credit Risk During CY21, the micro-credit portfolio clocked in at PKR 35bln (CY20: PKR 31bln). The lending portfolio is dominated by livestock (40.1%) and agriculture (16.7%). Non Performing Loans of the bank recorded a significant increase to PKR 1.7bln (end-Dec21: PKR 1.0bln). The management of asset quality, going forward, remains essential. The infection ratio increased to 3.2% as of end-June22.

Market Risk U Bank's investment portfolio comprises 25.6% of total earning assets. At end-Dec21, the investment book stood at PKR 46.5bln (end-Dec20: PKR 17.9bln) due to investment in mutual funds. The investment portfolio remained dominated by government securities. In end-June22, total earning assets sizably increased to PKR 103bln (end-Dec21: PKR 88bln). The investment book further increased to PKR 48.7bln primarily vested in government securities.

Funding The total borrowing as at end-Dec21 stood at PKR 39,874mln (end-Dec20: PKR 17,285mln) elevated sizably to finance advances and investment side. Deposit concentration risk remains a concern, as the top 50 depositors accounted for 60.0% of the total deposits. In end-June22, the bank's advances to deposits ratio (ADR) stood at 79.1% (end-Dec21: 62.5%).

Cashflows & Coverages U Bank regularly monitors its liquidity through its Asset and Liability Management Committee (ALCO) and aligns asset-liability mismatch accordingly. The Bank witnessed an improvement in its liquidity profile, as evident by the liquid assets to borrowings and deposits improved to 84.4% as of end-Dec21 (end-Dec20: 57.5%) driven by an increase in liquid investments. In end-June22, liquid assets demonstrated a positive growth and stood at PKR 37.5bln (end-Dec: PKR 33.2bln).

Capital Adequacy The bank's equity base was enhanced to PKR 7,489mln (end-Dec20: PKR 5,674mln) where the share capital increased to PKR 4bln. Equity to total assets remains largely same around 6.6%. In end-June22, the equity base of the bank improved to PKR 7,584mln.

PKR mln

U Microfinance Bank Limited Listed Public Limited	Jun-22 6M	Dec-21 12M	Dec-20 12M	Dec-19 12M
A BALANCE SHEET				
1 Total Finances - net	53,184	35,388	31,283	20,984
2 Investments	48,719	46,565	17,954	6,970
3 Other Earning Assets	1,574	6,212	8,467	3,009
4 Non-Earning Assets	11,820	17,427	14,286	8,737
5 Non-Performing Finances-net	(1,036)	(1,012)	(1,277)	390
Total Assets	114,262	104,578	70,713	40,090
6 Deposits	65,918	55,000	46,105	23,290
7 Borrowings	38,531	39,874	17,285	12,684
8 Other Liabilities (Non-Interest Bearing)	2,227	2,213	1,648	1,065
Total Liabilities	106,675	97,087	65,038	37,039
Equity	7,584	7,489	5,674	3,051
B INCOME STATEMENT				
1 Mark Up Earned	8,438	12,216	10,134	7,266
2 Mark Up Expensed	(5,180)	(5,589)	(4,342)	(3,843)
3 Non Mark Up Income	793	1,278	1,263	939
Total Income	4,051	7,904	7,055	4,363
4 Non-Mark Up Expenses	(3,042)	(5,062)	(4,295)	(3,220)
5 Provisions/Write offs/Reversals	(248)	(1,513)	(1,580)	(838)
Pre-Tax Profit	761	1,329	1,180	304
6 Taxes	(73)	(218)	(274)	(51)
Profit After Tax	688	1,111	906	254
C RATIO ANALYSIS				
1 Performance				
Portfolio Yield	29.2%	32.4%	38.0%	34.3%
Minimum Lending Rate	38.0%	35.9%	38.4%	40.3%
Operational Self Sufficiency (OSS)	106.8%	109.0%	110.2%	103.7%
Return on Equity	18.3%	16.9%	20.8%	8.7%
2 Capital Adequacy				
Net NPL/Equity	-13.7%	-13.5%	-22.5%	12.8%
Equity / Total Assets (D+E+F)	6.6%	7.2%	8.0%	7.6%
Tier I Capital / Risk Weighted Assets	13.4%	11.5%	16.3%	11.8%
Capital Adequacy Ratio	17.8%	16.4%	21.7%	16.7%
Capital Formation Rate [(Profit After Tax - Cash Dividend) / Equity]	13.2%	19.6%	26.4%	9.0%
3 Funding & Liquidity				
Liquid Assets as a % of Deposits & Short term Borrowings	48.6%	52.5%	57.5%	50.3%
Demand Deposit Coverage Ratio	874.2%	869.6%	780.6%	491.4%
Liquid Assets/Top 20 Depositors	149.0%	139.1%	96.1%	N/A
Funding Diversification (Deposits/(Deposits+Borrowings+Grants))	63.1%	58.0%	72.7%	64.7%
Net Advances to Deposits Ratio	79.1%	62.5%	65.1%	91.8%
4 Credit Risk				
PAR 30 Ratio	3.3%	2.8%	0.1%	4.1%
True Infection Ratio	3.3%	2.8%	0.1%	4.1%
Risk Coverage Ratio (PAR 30)	159.8%	198.9%	3660.5%	56.6%

Credit Rating

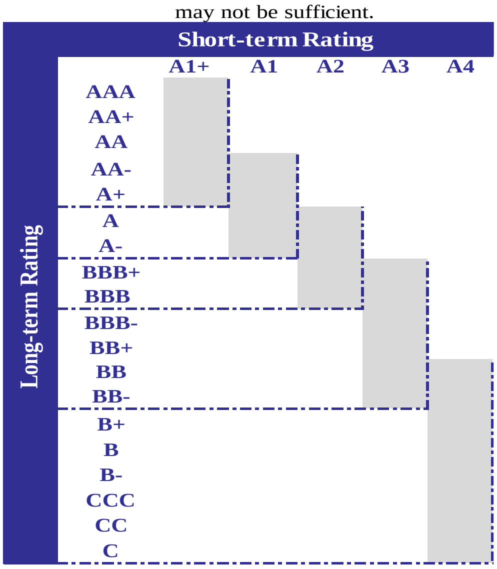
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

Disclaimer: PACRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information. Contents of PACRA documents may be used, with due care and in the right context, with credit to PACRA. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

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
(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent