



The Pakistan Credit Rating Agency Limited

Rating Report

Union Microfinance Company Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
26-Apr-2024	BB+	A3	Stable	Maintain	Yes
26-Apr-2023	BB+	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Union Microfinance Company (the Company) is a public company limited by shares and was incorporated in Pakistan as a Non-Banking Finance Company in July 2021, under the license issued in terms of rule 5(6) of the Non-Banking Finance Company Rules 2003 and Companies Act, 2017. The company was incorporated with a mission to tap the unbanked population and bring them into the ambit of financial inclusion, with a special focus on women, particularly those working in the cottage industry across the country. The company's loan portfolio comprises mainly three types of products: Union Salary Loan, pensioners' loan, and Union Gold loan (secured by gold). As an MFI, Union Microfinance Company faces funding constraints as it cannot mobilize deposits. The company relies on shareholder equity, loans, and internal profits to fund its operations. The Company is a relatively newer player in the sector which explains its limited footprint constrained to a single branch. The Gross Loan Portfolio of the company has grown to PKR 82mln during CY23 (PKR 56mln, CY22). Consequently, the markup earned by the company also increased to PKR 21mln during the year ending Dec 23. However, the company incurred a net loss of PKR 43mln as Union Microfinance Company borrows from commercial banks and the Pakistan Microfinance Investment Company, but its limited income falls short of covering the high costs of funds and operational expenses. However, the company has had no non-performing loans so far. The company's governance structure is adequate, with a board of directors comprising experienced professionals with considerable expertise in the financial sector. The ratings reflect the limited geographical presence of the company that poses a hindrance to growth in the short term, a meager market share in terms of the loan portfolio, and active borrowers. The rating watch incorporates the increase in the non-performing loans and diluted profitability within the microfinance sector triggered by the increased borrowing rates and high inflation which has diminished the disposable income of micro borrowers thus hampering their debt-repaying ability. Further, Union Microfinance's net losses have consistently surged over the years resulting in the dilution of the equity base of the company to PKR 51.6mln (PKR 62.7mln, CY22). Moreover, the company's geographical footprint has further decreased owing to the closure of 2 branches during the year signifying its difficulties in materializing projected expansion plans.

The company's ratings are contingent upon its ability to attain positive performance metrics in terms of growth in market share, net profitability, and equity base. Further, enhancement in the company's footprint through the addition of more branches is imperative for the sustainability of ratings.

Disclosure

Name of Rated Entity	Union Microfinance Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology Rating Modifiers(Apr-23),Methodology Microfinance Institution Rating(Oct-23)
Related Research	Sector Study Microfinance(Sep-23)
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Profile

Structure Union Microfinance Company Limited (UMCL) is a non-banking finance company (a for-profit organization) registered under the license issued in terms of rule 5(6) of the non-banking finance companies (establishment & regulation) Rules, 2003 (NBFC Rules). UMCL was established in July 2021 and started its operations in February 2022 with a branch at Jami Commercial street, DHA, Karachi.

Background UMCL emerged in July 2021, with the mission to tap the unbanked population and bring them into the ambit of financial inclusion. The Company has taken up a special focus on women, especially those working in the cottage industry, across the country.

Operations Union Microfinance Company Limited is providing small loans to low-income individuals, mainly three types of products; Union Salary Loan, Pensioners' Loan, and Union Gold Loan (secured with gold). The Company is targeting and caters to individuals in the health and education sectors, and also home-based businesses being run by skilled women.

Ownership

Ownership Structure The Company is owned by Five individuals, where Mr. Zahair Amir Ali Pesnani has a major shareholding, owning ~34% of the shares, while the rest is held by the other four shareholders.

Stability The ownership structure is perceived to remain the same, going forward

Business Acumen Union Microfinance is owned by individuals with good financial backgrounds and knowledge of the financial sector.

Financial Strength The sponsor's willingness and ability to support in case of need shall be seen in the years to come.

Governance

Board Structure The Board comprises four directors and is chaired by Mr. Zahair Amir Ali Pesnani. He is a Chartered Accountant and has worked in the financial services industry for over 30 years. He is also among the founding members and a part of the HR & Remuneration Committee. Mr. Mumtaz Hadi is the Chief Executive Officer and possesses extensive experience in the financial services industry.

Members' Profile All of the board members have international exposure and carry diversified expertise. Most of the members have been associated with providing microfinance services for a long.

Board Effectiveness The Board is subdivided into three committees for oversight of responsibilities. These are (i) HR & Remuneration Committee (ii) Risk Management Committee & (iii) Audit Committee.

Transparency The internal audit department directly reports to the Audit Committee ensuring independence from the rest of the organization. M/S BDO Ebrahim & Co. Chartered Accountants are the External Auditors of the company and they continue to monitor the financial statements of the MFI diligently.

Management

Organizational Structure Eight departments make up the company's horizontally distributed organizational structure. Each department has a distinct head. The CEO is the direct supervisor of every department head. Each level's reporting structure and job descriptions are specified.

Management Team Key management personnel is qualified professionals .Mr.Atif Amin joined as Head of finance & Company Secretary.

Effectiveness One Management Committee, composed of all the departmental heads, is in place. The Management Committee minutes are formally documented and maintained. It is particularly established to administer Board Management as well as the performance of tier-I management.

MIS The Company has an MIS, "Munsalik's Shared Services" in place. Munsalik's Shared Services Platform has been envisioned to digitize Microfinance Institutions without large-scale technology and infrastructure investment.

Risk Management Framework The company has in place a separate Risk Management department to oversee various risks including credit, operational, and market risks. A risk management manual containing guidelines for credit, operational, liquidity, and market risk is in place to help senior management improve the risk management and internal control environment.

Technology Infrastructure The company has introduced a convenient and easily accessible product suite consisting of a Loan Management System (LMS) which digitizes the loan management processes (i.e. customer onboarding & loan origination) and a middleware (IRIS) whereby ONE integration provides access to all the branchless banking players in the financial ecosystem and third party services providers.

Business Risk

Industry Dynamics The microfinance industry continues to face challenges. The GLP stood at PKR 500 bln during CY23. The GLP portfolio of MFI reached PKR 500bln with an active borrower base of 9.2mln as of CY23. Currently, in Pakistan, there are 24 dedicated Microfinance institutions primarily operating which provide specialized microfinance services.

Relative Position Incorporated in July 2021, Union Microfinance entered the microfinance industry as a new operator while adopting a cautious strategy. Moving forward, the company served 400 borrowers and extended a total of PKR 45 million in loans, operating through three branches in Sindh with its headquarters situated in Karachi.

Revenue During CY23 Company's topline increased and stood at PKR 21mln (CY22: PKR 10mln), owing to an increase in markup on advances.

Profitability The company's performance during the period wasn't sufficient to cover the expenses including operating expenses, provisions, and taxes. During CY23, the net loss of the company stood at PKR ~43mln (CY22: PKR 34mln).

Sustainability Union Microfinance provides innovative digital lending solutions through real-time credit disbursements. The company has insured its total portfolio with EFU, adopting a cautious entry route.

Financial Risk

Credit Risk Union Microfinance's loan book is primarily concentrated in gold-backed EMI & bullet loans, representing 76% of the total portfolio, a fairly diversified product segmentation.

Market Risk Currently, no investment book is being maintained by Union Microfinance Company Limite

Funding During CY23, the company's funding is sourced primarily from the financial institutions. The borrowings from financial institutions increased and stood at PKR 92mln (CY22: PKR 26mln)

Cashflows & Coverages The Company's liquidity profile is considered adequate as the total lending of the company inclusive of lending to financial institutions to borrowing ratio stood at 73.1% followed by total lending to total assets ratio of 37.5%. During CY23, the portfolio yield of the company stood at 46.7% (CY22: 27.3%)

Capital Adequacy SECP has no minimum requirement for NBFIs, unlike SBP which requires MFBs to maintain their CAR at 15%.



Union Microfinance Company Limited
Public unlisted

Dec-23	Dec-22	Jun-22
12M	18M	12M

A BALANCE SHEET

1 Total Finances - net	82	56	58
2 Investments	-	-	-
3 Other Earning Assets	-	-	-
4 Non-Earning Assets	70	36	42
5 Non-Performing Finances-net	-	-	-
Total Assets	152	92	100
6 Deposits	-	-	-
7 Borrowings	92	21	12
8 Other Liabilities (Non-Interest Bearing)	9	8	8
Total Liabilities	101	29	19
Equity	52	63	81

B INCOME STATEMENT

1 Mark Up Earned	24	9	5
2 Mark Up Expensed	(15)	(2)	-
3 Non Mark Up Income	3	2	1
Total Income	13	9	6
4 Non-Mark Up Expenses	(56)	(27)	(24)
5 Provisions/Write offs/Reversals	(0)	(0)	(0)
Pre-Tax Profit	(43)	(18)	(19)
6 Taxes	(0)	(0)	(0)
Profit After Tax	(43)	(18)	(19)

C RATIO ANALYSIS

1 Performance

Portfolio Yield	35.8%	15.9%	33.9%
Minimum Lending Rate	101.4%	51.3%	176.6%
Operational Self Sufficiency (OSS)	39.0%	37.3%	23.2%
Return on Equity	-75.3%	-28.9%	-47.1%
Cost per Borrower Ratio	105,361.6	76,546.0	311,145.9

2 Capital Adequacy

Net NPL/Equity	0.0%	0.0%	0.0%
Equity / Total Assets (D+E+F)	33.9%	68.3%	80.7%
Tier I Capital / Risk Weighted Assets	N/A	N/A	N/A
Capital Adequacy Ratio	N/A	N/A	N/A
Capital Formation Rate [(Profit After Tax - Cash Dividend) / Equity]	-68.4%	N/A	N/A

3 Funding & Liquidity

Liquid Assets as a % of Deposits & Short term Borrowings	N/A	N/A	N/A
Demand Deposit Coverage Ratio	N/A	N/A	N/A
Liquid Assets/Top 20 Depositors	N/A	N/A	N/A
Funding Diversification (Deposits/(Deposits+Borrowings+Grants))	0.0%	0.0%	0.0%
Net Advances to Deposits Ratio	N/A	N/A	N/A

4 Credit Risk

Top 20 Advances / Advances	5.5%	19.7%	29.7%
PAR 30 Ratio	0.0%	0.0%	0.0%
Write Off Ratio	0.0%	0.0%	0.0%
True Infection Ratio	0.0%	0.0%	0.0%
Risk Coverage Ratio (PAR 30)	N/A	N/A	N/A

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB	
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	Very high credit risk. Substantial credit risk "CCC" Default is a real possibility.
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term 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.
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 surveil 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):

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

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(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

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- (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)

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- (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 | 17-(a)
- (19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)

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