The Pakistan Credit Rating Agency Limited

Rating Report

Apna Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Oct-2019	BBB+	A3	Stable	Maintain	-
30-Apr-2019	BBB+	A3	Stable	Maintain	-
04-Dec-2018	BBB+	A3	Stable	Maintain	-
28-May-2018	BBB+	A3	Stable	Upgrade	-
10-Nov-2017	BBB	A3	Stable	Maintain	YES
10-May-2017	BBB	A3	Stable	Downgrade	-
07-Apr-2016	BBB+	A3	Positive	Maintain	-
07-Apr-2015	BBB+	A3	Stable	Upgrade	-
12-May-2014	BBB	A3	Positive	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings capture sustained risk profile of Apna Microfinance Bank ("the bank"). Sponsors' committed efforts to arrest shortfall in minimum CAR benchmark is witnessed through persistent equity injections (1HCY19: PKR~100mln, CY18: PKR~400mln). However, CAR continues to remain below the regulatory benchmark at~10% as at End-1HCY19 (End-CY18: ~9%). Although improving slightly, this remains a key concern. Asset quality, when segregated into old (prior Nov-16) and new portfolio, displays different outlooks, wherein non-performing loans (NPLs) from the current portfolio clocked in at ~4% of the Gross Loan Portfolio (GLP). Rise in NPL ratio may pose challenge given limited profitability. Overall, infection ratio stood at ~14% (End-CY18: ~13%). Disbursal of fresh loans is made to quality customers and is accompanied by stricter follow-ups. Meanwhile, stringent efforts to recover older NPLs are being carried out; the remaining size, though, is still huge. The ratings take into account sponsors' utmost priority to cleanse the old loan book. Auditor opinion is currently qualified in this regard. On the performance front, the bank has been able to almost double its income at the gross level, however, translating into thin profits owing to higher operating costs. Going forward, with the prevalent economic environment, cost rationalization is the key challenge to the bank to keep its margins intact. Additionally, building up a stable and diverse deposit base is fundamental to fuel the momentum of growth.

The ratings are dependent upon cleansing of the older lending book alongside maintaining health of fresh disbursements. Compliance with CAR is essential. Besides, improved profitability is of significance and any further deterioration in asset quality or CAR will have a negative impact on the ratings.

Disclosure	
Name of Rated Entity	Apna Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | MFI (Jun-19)
Related Research	Sector Study | Microfinance(Sep-19)
Rating Analysts	Muhammad Usman | muhammad.usman@pacra.com | +92-42-35869504

Profile

Structure Apna Microfinance Bank Limited (hereinafter referred to as "the bank") was incorporated in May 2003 as a Public Limited Company under the Companies Act, 2017 (formerly Companies Ordinance, 1984). The bank is listed on the Pakistan Stock Exchange (PSX) since the commencement of its operations, in 2005.

Background In June 2015, the bank was granted a national level license subsequent to completion of regulatory capital requirement. Presently, the bank operates with a network of 123 branches spread across Pakistan. The Head Office of the bank is located on Sundar Das Road, Lahore.

Operations The bank is offering a wide variety of lending products customized according to the needs of various communities. These include loans for farmers, livestock loans, agri-loans, house loans, tractor loans, salary loans, business loans, gold backed loans, and others, catering specific needs of the unbanked individuals. The bank also has a broad range of serviceable deposits that are mobilized through a number of current, saving and time deposit products.

Ownership

Ownership Structure Apna Microfinance Bank is a part of United International Group (UIG) with major ownership stake of ~70%, vesting with the group companies - United Insurance Company (UIC) (~45%) and United Track Systems (Pvt.) Limited (~20%). UIG is led by its Founder and Chairman – Mian Akram Shahid – the single largest shareholder. Owing to Mr. Shahid's indirect shareholding in Apna MFB through UIC (being the main sponsor) and direct shareholding in the bank (~4%), he is considered to be the ultimate/main sponsor of the bank.

Stability Ownership structure is stable, as the UIG is expected to remain the sponsor of the bank.

Business Acumen UIG has gradually strengthened its foothold in various business ventures.

Financial Strength The group is diversified into various other sectors including insurance, tracking services, information technology and business consultancy, thereby depicting sound financial strength.

Governance

Board Structure The Board of Directors comprises seven members. Mr. Mian Akram Shahid is the Chairman of the Board. Five directors are representatives of UIG, while one director holds his place on the board, by virtue of having a ~16% ownership stake in the bank. The composition of the board comprises one independent director.

Members' Profile Mr. Akram Shahid is a seasoned professional having experience of more than 34 years. The other board members also have a wealth of professional experience. Overall, board members' profile is considered adequate.

Board Effectiveness The Board has four sub-committees; (i) Executive (ii) HR & Remuneration (iii) Risk Management and (iv) Audit Committee.

Financial Transparency Ilyas Saeed & Co. Chartered Accountants are the External Auditors of the bank. The firm has expressed a qualified opinion on the CY18 Financial Statements, finding the tagging of the old portfolio (prior Nov-16 SBP suspension order of lending) unsatisfactory and subjective.

Management

Organizational Structure The revived organization structure has been benefiting the bank in curbing the prevalent risks, to an acceptably low level on a timeline basis. The management is committed to further strengthening its operations.

Management Team Top management, alongside mid-tier managers and branch staff, are experienced individuals, well-versed with the knowledge of their business. Integrity is considered of high importance to the management team.

Effectiveness Effective management practices accompanied by formal meetings and strong controls have improved the overall operational efficacy of the bank.

MIS The bank uses the AB3 - Autosoft, as the core banking software, which sufficiently serves the purpose of meeting banking reporting requirements.

Risk Management Framework Separate Risk Division is in place along with adequate mechanism for assessing credit worthiness and non-performing portfolio. Risk Management policies and manuals have been redesigned in the recent past and are updated periodically.

Technology Infrastructure Technological infrastructure is considered sound. Using AutoSoft's banking software, the bank is able to take advantage of a wide range of banking solutions, tailored to automate and manage the daily needs of a microfinance bank.

Business Risk

Industry Dynamics Pakistan Microfinance Industry comprises 41 microfinance providers including 11 Microfinance Banks (MFBs), 15 Microfinance Institutions (MFIs), 6 Rural Support Programmes (RSPs) and 9 other projects. MFBs dominate the Industry with a share in lending portfolio of ~70%. The total Gross Loan Portfolio of MFBs amounted to PKR~206,003mln as at End-June'19, recording a meagre growth of ~9% during the period.

Relative Position The bank's current direction is focused towards emerging out of the turmoil suffered in the prior years. Considerable results have been achieved in this regard. The bank has maintained its market share during the period under review. As at End-1HCY19; its share in the market, in terms of Gross Loan Portfolio and Micro-Deposits, stood at ~5% (End-CY18:~5%) and ~7% (End-CY18:~7%) respectively.

Revenue The bank recorded a net interest/markup revenue of PKR~848mln during 1HCY19 (1HCY18: PKR~582mln), with a period-on-period growth of 46%. Channeling of funds to better yield products has also improved the asset yield of the bank to 12% (1HCY18: 10%) during the period under review. Improved income has resulted in improved spreads during the period.

Profitability Net profitability, for 1HCY19, clocked in at PKR~41mln showcasing a healthy rise of ~26%, compared to PKR~32mln in 1HCY18. The bank recorded income related to insurance claims, amounting to PKR~126mln, during the period (1HCY18: PKR~98mln). Regardless, generation of profits from core operations is critical to the bank.

Sustainability The bank has achieved considerable success in turning around its deteriorated position except meeting the CAR requirement. Stringent management efforts and team cohesiveness are reflected in the stabilized position of the bank. Meanwhile, recoveries from the previously infected loan book and generation of profit from core operations are key determinants to withhold the bank's sustainable position.

Financial Risk

Credit Risk Gross Loan Portfolio of the bank stood at PKR~10,377mln as at End-1HCY19 (End-CY18: PKR~10,087mln), demonstrating a modest increase of ~3%. Infection ratio remained stagnant at ~14% (End-CY18: ~13%). It is noted that infection pertaining to fresh disbursal is low. Recovery against old loan portfolio remains critical.

Market Risk Due to low borrowing from financial institutions, amounting to PKR~8mln (End-CY18: PKR~9mln) along with a good mix of low cost deposits, the market risk of the bank remains low. Although, the high interest rate environment will remain to be a challenge for the bank, as for the other players in the industry.

Funding Growth in GLP during 1HCY19 was kept low. However, as and when, the bank takes up pace to increase its business size, expansion in funding base becomes the key issue. Total deposits of the bank clocked in at PKR~16,818mln as at End-1HCY19 (End-CY18: PKR~15,866mln), representing steady yet slow growth. Deposit mobilization will remain the key source of the bank's funding going forward.

Liquidity Liquidity profile has marginally improved as the liquid assets-to-deposits and borrowings ratio rose to ~36% as at End-1HCY19 (End-CY18: ~33%). Increased investment in deposit accounts has played a major role in this regard.

Capital Adequacy The bank remained non-compliant in meeting the minimum CAR requirement of 15%. CAR as at End-1HCY19 was recorded at ~10.1% (End-CY18: ~9.1%). The CAR increased during the period under review, on the back of a capital injection of PKR 100mln by the sponsors.

Apna Microfinance Bank Limited — **Financial Summary**

PKR mln

BALANCE SHEET	30-Jun-19	31-Dec-18	31-Dec-17	31-Dec-16
	6M	Annual	Annual	Annual
Earning Assets				
Total Finances	8,958	8,879	4,772	4,920
Investments	790	783	554	598
Deposits with Banks	3,980	2,911	4,049	4,233
	13,729	**12,573**	**9,375**	**9,752**
Non Earning Assets				
Non-Earning Cash	1365	1586	1202	1075
Net Non-Performing Finances	465	388	130	571
Fixed Assets & Others	3186	3076	3276	2156
	5,016	**5,050**	**4,608**	**3,802**
TOTAL ASSETS	**18,745**	**17,623**	**13,984**	**13,554**
Interest Bearing Liabilities				
Deposits				
CASA	10,576	10,600	7,673	6,335
Time Deposits	6,242	5,266	4,856	6,012
	16,818	15,866	12,529	12,347
Borrowings	8	9	202	204
Non Interest Bearing Liabilities	306	274	232	296
TOTAL LIABILITIES	**17,131**	**16,149**	**12,963**	**12,847**
EQUITY (including revaluation surplus)	**1609**	**1468**	**1012**	**693**
Deferred Grants	**4**	**5**	**9**	**15**
TOTAL LIABILITIES & EQUITY	**18,745**	**17,623**	**13,984**	**13,554**

INCOME STATEMENT	30-Jun-19	31-Dec-18	31-Dec-17	31-Dec-16
Interest / Mark up Earned	1,379	2,158	1,578	1,442
Interest / Mark up Expensed	(531)	(801)	(704)	(672)
Net Interest / Markup revenue	**848**	**1,357**	**874**	**770**
Other Operating Income	64	177	51	62
Total Revenue	**912**	**1,534**	**925**	**832**
Other Income	165	250	467	51
Non-Interest / Non-Mark up Expensed	(892)	(1,594)	(1,309)	(1,135)
Pre-provision operating profit	185	190	84	(252)
Provisions	(107)	(89)	(273)	(846)
Pre-tax profit	78	100	(188)	(1,098)
Taxes	(38)	(47)	109	362
NET INCOME	**41**	**53**	**(80)**	**(735)**

Ratio Analysis	30-Jun-19	31-Dec-18	31-Dec-17	31-Dec-16
Performance				
ROE	6%	4%	-9%	-85%
Cost-to-Total Net Revenue	83%	89%	94%	129%
Capital Adequacy				
Equity/Total Assets	9%	8%	7%	5%
Capital Adequacy Ratio as per SBP	10%	9%	8%	7%
Loan Loss Coverage				
Non-Performing Advances /Gross Advances	14%	13%	22%	23%
Loan Loss Provisions / Non-Performing Advances	69%	70%	90%	62%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	36%	33%	46%	47%
Advances / Deposits	56%	58%	39%	44%
CASA deposits / Total Customer Deposits	63%	67%	61%	51%
Intermediation Efficiency				
Asset Yield	23%	20%	16%	20%
Cost of Funds	7%	6%	6%	8%
Spread	16%	14%	11%	12%
Outreach				
Branches	123	123	122	116

Rating Scale | Corporate

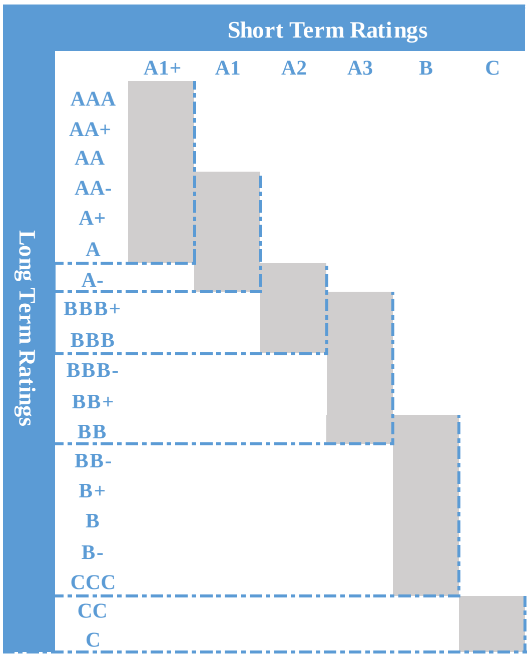
2019

Credit Rating Scale & Definitions

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

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

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



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

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

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

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

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

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