The Pakistan Credit Rating Agency Limited

Rating Report

Apapna Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Apr-2020	BBB+	A3	Stable	Maintain	YES
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 (CY19: PKR~350mln, CY18 PKR~400mln). However, Bank's CAR stands at 12% as at Dec'19 (Dec'18:~9%) which is still below the regulatory benchmark of 15%. Though gradually improving, it still is a concern. The bank's credit delinquency has diluted in substance, as is witnessed from its NPL ratio of ~5% as at End-Dec'19 (End-Dec'18:~13%). This is achieved on the backdrop of cleansing a major chunk of the old portfolio (prior Nov-16), adopting a cautious approach towards fresh lending and building a finer recovery mechanism. Recovery cycle indicates an average of quarterly outstanding receivables, as asserted by the management. Auditor opinion is currently qualified for the bank and is expected to continue until the old loan portfolio clears out in totality. The ratings take into account sponsors' cognizance in this regard. Financial risk profile is demonstrated by grown liquidity, and comfortable Advances-to-deposits ratio (ADR), while profitability remains thin. Bearing the prevalent economic environment, cost rationalization is one of the key challenges to the bank in keeping its margins intact. Additionally, building up a stable and diverse deposit base is fundamental to fuel the momentum of growth. Under the current scenario, the nationwide lockdown due to the global pandemic - Covid-19, is certain to cast a significant impact on the whole microfinance industry. The key risks culminating from the current crisis are (i) loss of recovery (ii) halt in fresh disbursement and (iii) probable liquidity stretch. Though SBP's Relief Packages have come handy to the sector in protecting the credit quality of the players, the out-turn of the situation, and its 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. The ratings are also placed under "Watch" to monitor challenges arising from COV-19 outbreak. Compliance with CAR is essential, going forward. Besides, improved profitability is imperative.

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),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19)
Related Research	Sector Study | Microfinance(Sep-19)
Rating Analysts	Shazia Afzal | shazia.afzal@pacra.com | +92-42-35869504

Profile

Structure Apna Microfinance Bank Limited ("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 Pakistan Stock Exchange (PSX) since the commencement of its operations in 2005 under the Microfinance Institution Ordinance 2001.

Background In June-15, 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.

Operations With its core business purpose of poverty alleviation and financial inclusion, 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.

Ownership

Ownership Structure The Bank is a part of the United International Group (UIG) with major ownership stake of ~45% vesting with the United Insurance Company Limited and ~20% with the United Track Systems (Private) Limited. Overall ~74% of the bank's stake is held by the UIG Group.

Stability Going forward, ownership of the bank is expected to remain stable. Subsequent, to the year End Dec-18, the bank has converted the share deposit money of its sponsors into shares with no change in ultimate ownership of the bank, as the United Insurance Group is continuing to be the ultimate sponsors.

Business Acumen United International Group (UIG) has gradually strengthened its foothold in various business ventures. Currently, the group has interests in microfinance, insurance, tracking business, information technology, agriculture, and business consultancy. UIG is led by its Founder and Chairman – Mian Akram Shahid – the single largest shareholder.

Financial Strength United Insurance and Universal Insurance are the two main Companies of the group. The sponsor's willingness to support the bank is evident from the capital injection by the sponsors in recent periods. Owners of the bank are committed to inject further capital in the bank.

Governance

Board Structure The overall control of the bank vests in an eight member Board of Directors (BoD). Two of the board members are also the shareholders of the bank. The bank has one independent director on the Board as against the Prudential Regulations requirement for MFBs to have at least two independent directors. The board has four sub-committees; (i) Audit Committee (ii) HR and Remuneration Committee (iii) Risk Management Committee.

Members' Profile All the board members are experienced professionals carrying experience of an average of over ~20 years. Mr. Akram Shahid, Syed Rahat Ali Shah and Mr. Saleem Shaikh attended the Directors' training programs (DTPs). Despite other responsibilities, board members remained available for the bank.

Board Effectiveness During the year, five board meetings were held; the attendance of the board remained strong in the meetings. The board and committee's meeting minutes are formally maintained, showing high attendance of the members.

Financial Transparency The audit committee of the bank comprises of five members and is chaired by an independent director, Mr. Abdul Aziz Khan. A separate Internal Audit Department is in place which reports independently to the Audit Committee. M/S Ilyas Saeed & Co. Chartered Accountants is the external auditor of the bank.

Management

Organizational Structure Independent department of recovery had been established collateral to the disbursements in order to strengthen the recovery ratio. Broadly speaking, the SBP's audit in CY16 was focused on two basic requirements: (i) Overhauling of IT Infrastructure and (ii) Retrieving a strong recovery mechanism to reduce the swelled infection in lending.

Management Team New key management positions were created and filled by qualified professionals to strengthen the departmental results. These included Head of Recovery and Legal Departments, Head of Corporate Recovery and Liability and Head of Corporate Banking group. A total of five department heads report directly to the President.

Effectiveness Four Management Committees are in place namely i) Asset Liability Management (ALCO) ii) Credit, iii) Management, and iv) IT Steering at the senior management level to ensure operational efficiency and efficient decision making. The Management Committee minutes are formally maintained

MIS To enhance the data safety, management has significantly improved the Data collection and management center and has acquired program for compliance handling. Instituting a new recovery department has been the most essential ingredient in contributing to restoring an effective risk management for the bank.

Risk Management Framework As a consequence of the SBP inspection (as stated above), the bank envisaged betterment in risk management through improvement in overall control environment by revisiting and devising risk management policies and control procedures to manage its credit risk.

Technology Infrastructure Apna Bank uses Auto-banker II (ABII) as its core-banking software. Developed by a local vendor, ABII provides flexibility to consolidate records based on branch, repayment behavior, classification of loan and borrower profile.

Business Risk

Industry Dynamics As at End-Dec'19, the total Gross Loan Portfolio (GLP) of the overall industry amounted to PKR~305,753mln (End-Dec'18: PKR~274,707mln), recording a growth of ~11%, on a YoY basis. MFBs dominate the industry with a share in lending portfolio of ~70%. Going forward, the outbreak of the pandemic Covid-19, is expected to have a significant impact on the industry, since the consumers are part of a segment, which is deemed to be highly financially vulnerable. Reduced fresh disbursements and loss of recoveries may pose a challenge to the overall industry.

Relative Position During CY19, Apna MFB's Gross Loan Portfolio (GLP) clocked in at PKR~9.1bln (End-Dec18: PKR~10.1bln), recording a market share of ~4% (CY18:~4%). In terms of deposits, the bank recorded a higher market share of ~7% .

Revenue The bank recorded a net interest/markup revenue of PKR~1,690mln during CY19 (CY18: PKR 1357mln), with YOY growth of 24%. Channeling of funds to better yield products has also improved the asset yield of the bank, as it earned asset yield of 42% (CY18: 20%) during the period.

Profitability Earning assets of the bank increased to PKR ~15,076mln CY19 (End-Dec'18: PKR ~12,573mln) owing to an impressive increase in the bank's investment book. Due to inclusion of new portfolio, asset yield increased to ~42% (End-Dec'18: ~20%). Resultantly, spread increased to ~28% (End-Dec'18: ~14%).

Sustainability The bank was able to achieve profits in CY19 as a result of rigorous efforts of recoveries. At present, the bank's core focus is on increasing its core profitability and meeting the curtailed capital adequacy ratio (CAR). Current prevailing market conditions and lockdown may pose significant challenge to the bank's envisaged growth and recovery targets.

Financial Risk

Credit Risk Gross Loan Portfolio clocked at PKR~9.07bln as at End-Dec'19 (End-Dec'18: PKR~10.087bln), showing a decrease of ~10% due to conservative loan policy of management to hold its NPL ratio in control. Infection ratio dropped significantly to ~5% (CY18:~13%), as a major chunk of old loan book settles off.

Market Risk Low borrowings from financial institutions keeps the market risk in check. As Interest Rates take a downslide, the industry is expected to keep its spread intact.

Funding Keeping up with adequate funding base remains a key risk for the bank under the current circumstances. Total deposits of the bank clocked in at PKR~18,317mln at End-Dec'19 (End-Dec'18: PKR~15,866mln).

Liquidity Liquidity profile improved as liquid assets-to-deposits and borrowings ratio increased to ~42% as at End-Dec'19 (End-Dec'18: ~33%). Stable investment in government securities led to an improved liquidity position of the bank.

Capital Adequacy The bank remained non-compliant in meeting the minimum CAR requirement of 15%. CAR as at End-Dec'19 was recorded at ~12% (End-Dec'18: 9%). The CAR increased during the period on the back of capital injection of PKR 350mln by sponsors.

Apna Microfinance Bank Limited — **Financial Summary**

PKR mln

BALANCE SHEET	31-Dec-19	31-Dec-18	31-Dec-17	31-Dec-16
	Annual	Annual	Annual	Annual
Earning Assets				
Total Finances	8,685	8,879	4,772	4,920
Investments	946	783	554	598
Deposits with Banks	5,445	2,911	4,049	4,233
	15,076	**12,573**	**9,375**	**9,752**
Non Earning Assets				
Non-Earning Cash	1361	1586	1202	1075
Net Non-Performing Finances	194	388	130	571
Fixed Assets & Others	3912	3076	3276	2156
	5,467	**5,050**	**4,608**	**3,802**
TOTAL ASSETS	**20,543**	**17,623**	**13,984**	**13,554**
Interest Bearning Liabilities				
Deposits				
CASA	11,810	10,600	7,673	6,335
Time Deposits	6,508	5,266	4,856	6,012
	18,317	15,866	12,529	12,347
Borrowings	7	9	202	204
Non Interest Bearing Liabilities	345	274	232	296
TOTAL LIABILITIES	**18,669**	**16,149**	**12,963**	**12,847**
EQUITY (including revaluation surplus)	**1872**	**1468**	**1012**	**693**
Deferred Grants	**2**	**5**	**9**	**15**
TOTAL LIABILITIES & EQUITY	**20,543**	**17,623**	**13,984**	**13,554**

INCOME STATEMENT	31-Dec-19	31-Dec-18	31-Dec-17	31-Dec-16
Interest / Mark up Earned	2,900	2,158	1,578	1,442
Interest / Mark up Expensed	(1,209)	(801)	(704)	(672)
Net Interest / Markup revenue	**1,691**	**1,357**	**874**	**770**
Other Operating Income	121	177	51	62
Total Revenue	**1,812**	**1,534**	**925**	**832**
Other Income	369	250	467	51
Non-Interest / Non-Mark up Expensed	(1,798)	(1,594)	(1,309)	(1,135)
Pre-provision operating profit	383	190	84	(252)
Provisions	(294)	(89)	(273)	(846)
Pre-tax profit	90	100	(188)	(1,098)
Taxes	(36)	(47)	109	362
NET INCOME	**54**	**53**	**(80)**	**(735)**

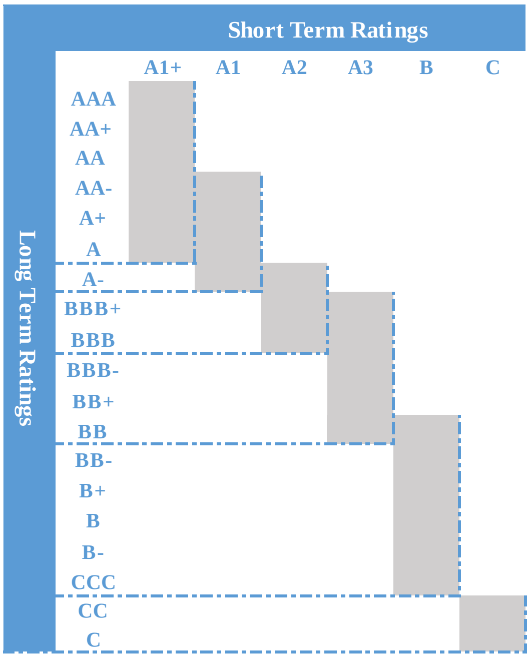
Ratio Analysis	31-Dec-19	31-Dec-18	31-Dec-17	31-Dec-16
Performance				
ROE	6%	4%	-9%	-85%
Cost-to-Total Net Revenue	82%	89%	94%	129%
Capital Adequacy				
Equity/Total Assets	9%	8%	7%	5%
Capital Adequacy Ratio as per SBP	12%	9%	8%	7%
Loan Loss Coverage				
Non-Performing Advances /Gross Advances	5%	13%	22%	23%
Loan Loss Provisions / Non-Performing Advances	60%	70%	90%	62%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	42%	33%	46%	47%
Advances / Deposits	48%	58%	39%	44%
CASA deposits / Total Customer Deposits	64%	67%	61%	51%
Intermediation Efficiency				
Asset Yield	42%	20%	16%	20%
Cost of Funds	14%	6%	6%	8%
Spread	28%	14%	11%	12%
Outreach				
Branches	123	123	122	116

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.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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