The Pakistan Credit Rating Agency Limited

Rating Report

Telenor Microfinance Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Apr-2021	A+	A1	Negative	Maintain	-
30-Apr-2020	A+	A1	Negative	Maintain	-
30-Oct-2019	A+	A1	Stable	Maintain	-
30-Apr-2019	A+	A1	Stable	Maintain	YES
07-Nov-2018	A+	A1	Stable	Maintain	YES
27-Apr-2018	A+	A1	Stable	Maintain	-
23-Nov-2017	A+	A1	Stable	Maintain	-
28-Apr-2017	A+	A1	Stable	Maintain	-
28-Apr-2016	A+	A1	Rating Watch	Maintain	-
08-Feb-2016	A+	A1	Stable	RW-Developing	-

Rating Rationale and Key Rating Drivers

The ratings take comfort from association of Telenor MFB ('the bank') with robust sponsors - Telenor Group (~55%) and the Chinese Fintech equity partner - Ant Financial, through its investment arm, AliPay (Hong Kong) Holding Limited (~45%). The bank's business profile emanates from its nationwide network of more than 170,000 registered branchless banking agents, serving over 8 million customers every month. The bank's strategic vision is focused towards digitization with notable developments underway for growth of the branchless platform, 'Easypaisa'. Ambition of a sustainable consumer platform rests upon increasing acquisition, retention and transactional throughput in branchless banking (BB) wallet accounts. While growth strategies for the Bank have been taken under consideration, overall performance indicators reflected a deteriorated outlook in CY20, mainly owing to COVID-19 pandemic and identification of legacy challenges of 2019. Consequently, the bank's advances declined to PKR 11,090mln as at End-Dec'20 (End-Dec'19: PKR 19,999mln), indicating a fall of ~45%. The Bank has cut its losses in CY20 as compared to the corresponding period, however there is still a significant shortfall. Management's commitment to recoup the asset health and consolidate the bank's position within the stipulated time is an acute necessity. Moreover, since the projected outlook of the bank indicates absorbing significant cash and accounting losses, timely yet matching sponsor support through Equity injections is essential. Equity injections of USD 45mln and USD 41mln in Aug20 and Jan21 respectively represents the willingness and the ability of the sponsors to support the Bank. On an Industry level, the nationwide lockdown due to the global pandemic - Covid-19, is expected to cast a significant impact on the whole microfinance sector. Under the current scenario, continuity of COVID-19 pandemic (penetration of third wave in Pakistan) will poise challenge to business and asset quality. Though SBP's Relief Packages have come handy to the sector in protecting the credit quality of the players during the first wave, the out-turn of the situation, and its relative impact on the risk profiles of industry players, including Telenor, is yet to unfold in the days to come.

The ratings are dependent upon the out-turn of management's plans to steer the risk profile of the Bank towards improved trajectory. Timely Sponsor Support is imperative. The Assigned Outlook is reflective of the short term challenges that the Bank's business and financial risk profile are facing, particularly emanating from economic meltdown and Covid-19 repercussions.

Disclosure

Name of Rated Entity	Telenor Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | MFI (Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Microfinance(Sep-20)
Rating Analysts	Ahmad Saad Siddiqi | ahmad.saad@pacra.com | +92-42-35869504

Profile

Structure Telenor Microfinance Bank Limited (hereinafter referred to as "Telenor" or "the bank") was incorporated with the SECP in 2005, under the Companies Ordinance, 1984 (now the Companies Act, 2017). The head office of the bank is located in the Central Commercial Area, Karachi.

Background The bank was previously a wholly owned subsidiary of Telenor Pakistan B.V (Telenor Group). In Nov'18, Ant Financial - an affiliate fintech company of the Chinese Alibaba Group, acquired ~34% share in the bank through its investment arm - Alipay (Hong Kong) Holding Limited. In Nov'19, Ant Financial injected further capital to take its ownership share to ~45%

Operations The bank operates through a nationwide network of 87 branches in the low-income areas within Pakistan, offering a diversified range of lending products. It has also been offering branchless banking (BB) services since 2009, to its clients through its BB Brand "Easypaisa".

Ownership

Ownership Structure The shareholding of Telenor Pakistan B.V stands at ~55%, while Ant Financial holds a ~45% stake in the bank.

Stability Ownership structure witnessed a significant change during CY19. Additional equity injection may be necessitated due to significant losses.

Business Acumen Telenor ASA, the parent company of the Telenor Group is a subsidiary of the Government of Norway. It is one of the world’s major mobile operators, headquartered in Oslo, Norway, with operations spread across multiple countries. Inclusion of Ant Financial is considered positive for the bank, as the group is one of the leading fintech conglomerates across the globe. The bank is well poised to avail benefit from the strategic vision and direction of Ant Financial.

Financial Strength Financial muscle of the sponsors is considered even more robust following induction of Ant Financial, as an equity partner.

Governance

Board Structure The overall control vests in an eight member Board of Directors. Three directors, including the chairman - Mr. Irfan Wahab Khan, are representatives of the Telenor Group. Due to emergence of Ant Financial as an equity partner, the Board composition was revised in CY19. Ant Financial is represented by three directors leading to equal representation from both ownership groups. Two independent directors complete the composition of the board.

Members’ Profile The Board members carry extensive experience in the telecom industry and financial services. Inclusion of Ant Financial, considered to be fintech tycoons, have added strength to the overall Board members' profile.

Board Effectiveness The Board exercises its oversight via five committees, namely (i) Audit Committee (ii) Risk Management Committee (iii) IT Committee and (iv) People Committee.

Transparency EY Ford Rhodes Chartered Accountants are the external auditors of the bank. They expressed an unqualified opinion on the financial statements for the year ended Dec'20.

Management

Organizational Structure The bank's operations are grouped under nine departments with each department head reporting directly to the CEO, while the head of internal audit, reports to the audit committee.

Management Team The bank underwent several key management changes during CY19. In Oct'19, Mr. Mudassar Aqil, took charge as the CEO, carrying with him over two decades of experience in the banking industry. In the same month, Mr. Farhanullah Khan joined the bank as the CFO. He too, has a wealth of experience in the financial sector, spanning over two decades.

Effectiveness Telenor has designated multiple management committees to manage and oversee operational efficacy. The Information Technology Steering Committee (ITSC), Management Risk Committee (MRC), Compliance Committee (CC) Asset-Liability Committee (ALCO), etc. have regular oversight on Financial, Risk, Operational, Governance, Compliance, and IT related matters of the company. These committees also have Board oversight committees.

MIS Detailed MIS reports are generated to support the senior management in timely and effective decision making. With the paramount focus diverted on the BB front, special MIS reports to monitor the KPIs related to BB progress are generated and presented to the Board on a monthly and quarterly basis.

Risk Management Framework Telenor has an established Risk Division Unit in place to oversee associated risks. The bank has developed and deployed a credit policy manual, which comprises guidelines for risk management framework.

Technology Infrastructure In light of the forecasted increase in traffic on Easypaisa platforms, the bank's technological infrastructure is considered robust.

Business Risk

Industry Dynamics Pakistan’s Microfinance Industry comprises 39 microfinance providers including 12 Microfinance Banks, 17 Microfinance Institutions (MFIs), 6 Rural Support Programmes and 4 other projects. As at end-Dec'20, the total active borrowers of the industry stood at 7.0mln (FY20: 6.9mln), which shows a marginal increase of 1.4%. However, the restrictions are being lifted only in a phased manner and the degree of relaxations vary across regions depending upon the severity of covid-19 pandemic. The Industry Gross Loan Portfolio (GLP) clocked in at PKR 324,155mln (FY20: PKR 299,948mln). The surge in active borrowers and GLP continues contributed by the MFB peer group, which added over 170,000 clients and over PKR 115,000mln of GLP. The PAR>30 days decreased from 4.8% to 3.7% as the infection ratio for MFBs declined from 5% to 3.3% whereas it increased for the MFIs from 4.2% to 4.9%.

Relative Position As at End-CY20, the bank held 3% (CY19: 7%) of the total gross loan portfolio of the microfinance industry, and a 10% share (CY19: 15%), in terms of deposits.

Revenue During CY20, the bank earned a markup of PKR 5,981mln (CY19: PKR 9,289mln), a decline of 36% compared to the corresponding period. Additionally, earnings from the branchless banking segment amounted to PKR 5,742mln (CY19: PKR 7,326mln), depicting a decline of 22%.

Profitability As at 31st December 2020, loss after taxation amounted to PKR 10,704mln (CY19: PKR 16,232mln), which represents improvement by 34%. Contributing factors include markup expense, which declined by 25% to PKR 2,771mln (CY19: PKR 3,671mln). Non-markup expense also experienced a fall to PKR 18,814mln (CY19: PKR 21,070mln). Along with non-markup income, which rose by 20% to PKR 1,455mln (CY19: PKR 1,212).

Sustainability In light of the safety precautions taken during the global pandemic, the importance of branchless banking, has risen manifold. On the other hand, the effect of Covid-19 will put pressure on the growth prospects, liquidity and future infection of the loan book, of all industry players.

Financial Risk

Credit Risk Even though the bank’s loan book represents a fairly diversified product segmentation, as at End-CY20, the bank's infection ratio fell to 17% (End-CY19: 21%). The bank has written off advances amounting to PKR 7,841mln during CY20 (CY19: PKR 2,651mln). Management has cautiously recorded general provision, relating to branches with high delinquency ratios and control weaknesses.

Market Risk The bank’s earning assets comprising deposit accounts, call money lending and investments in market treasury bills made up 48% of its total assets as at End-CY20 (End-CY19: 43%). Investments such as Market Treasury Bills, tend to provide a hedge against interest rate volatility, along with liquidity support to the bank. Therefore, a fall in such investments has elevated the market risk.

Funding The bank’s external funding primarily consists of deposits, clocking in at PKR 36,964mln as at End-CY20 (End-CY19: PKR 41,171mln), depicting a decline of 10% during the period under review.

Liquidity Liquidity profile slightly changed during the period under review, as evident by the bank's liquid assets to deposits and borrowings ratio falling to 57%% as at EndCY20 (End-CY19: 60%), majorly due to a decrease in investment in government securities.

Capital Adequacy As at End-CY20, the bank's CAR fell to 18.89% (End-CY19: 24.6%), as a result of equity erosion due to significant losses. Subsequent equity injections from shareholders between the year 2018-2021 aggregating in total to USD 235 million including USD 45 million and USD 41 million injected in August 2020 and January 2021 respectively.

PKR mln

Telenor Microfinance Bank Limited Private Limited	Dec-20 12M	Dec-19 12M	Dec-18 12M	Dec-17 12M
A BALANCE SHEET				
1 Total Finances - net	10,623	21,679	32,786	24,746
2 Investments	11,855	13,773	9,008	6,767
3 Other Earning Assets	13,074	12,149	9,286	7,507
4 Non-Earning Assets	16,245	14,938	11,217	8,092
5 Non-Performing Finances-net	468	(1,680)	159	16
Total Assets	52,265	60,860	62,456	47,128
6 Deposits	36,964	41,171	42,275	36,665
7 Borrowings	-	-	-	-
8 Other Liabilities (Non-Interest Bearing)	10,137	11,642	6,513	5,457
Total Liabilities	47,100	52,813	48,788	42,122
Equity	5,147	8,028	13,613	4,981
B INCOME STATEMENT				
1 Mark Up Earned	11,723	16,614	16,081	13,839
2 Mark Up Expensed	(2,771)	(3,671)	(2,595)	(1,767)
3 Non Mark Up Income	1,455	1,212	1,027	712
Total Income	10,407	14,155	14,513	12,784
4 Non-Mark Up Expenses	(18,814)	(21,070)	(5,973)	(3,629)
5 Provisions/Write offs/Reversals	(2,015)	(8,869)	(1,387)	(271)
Pre-Tax Profit	(10,422)	(15,784)	7,153	8,884
6 Taxes	(282)	(447)	(402)	(271)
Profit After Tax	(10,704)	(16,232)	6,751	8,613
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	15.8%	21.0%	24.6%	25.6%
Non-Mark Up Expenses / Total Income	180.8%	148.8%	41.2%	28.4%
ROE	-162.5%	-150.0%	72.6%	172.9%
2 Capital Adequacy				
Equity / Total Assets	9.8%	13.2%	21.8%	10.6%
Capital Adequacy Ratio	18.9%	24.6%	37.0%	19.5%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	57.1%	59.9%	40.4%	39.3%
(Advances + Net Non-Performing Advances) / Deposits	30.0%	48.6%	77.9%	67.5%
Current Deposits / Deposits	58.3%	32.2%	26.1%	39.8%
SA Deposits / Deposits	9.7%	14.6%	22.7%	10.8%
4 Credit Risk				
Non-Performing Advances / Gross Advances	16.5%	21.1%	4.1%	1.0%
Non-Performing Finances-net / Equity	9.1%	-20.9%	1.2%	0.3%

Credit Rating

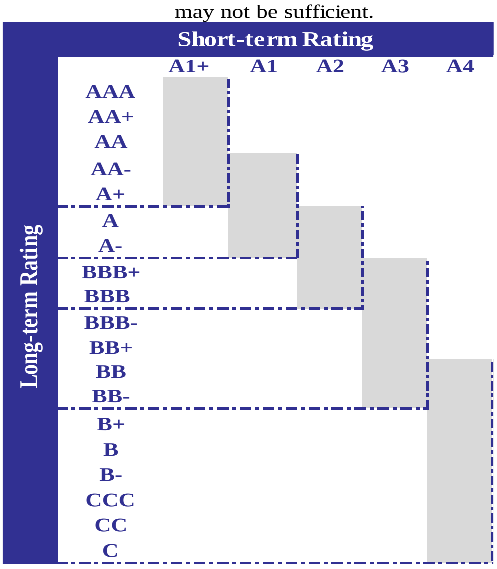
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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(Credit Rating Companies Regulations,2016)

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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**

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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)

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(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.

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(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)

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(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)

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(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)

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