RATING REPORT

Advans Pakistan Microfinance Bank Limited

REPORT DATE:

April 28, 2020

RATING ANALYST:

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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	BBB+	A-3	BBB+	A-3
Rating Outlook	Rating Watch - Developing		Stable	
Rating Date	*April 28, 2020*		*April 26, 2019*	

COMPANY INFORMATION	
Incorporated in 2012	**External auditors:** A. F. FERGUSON & CO., Chartered Accountants
Public Limited Company	**Chairman of the Board:** Dr. Claude Falgon
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Guillaume Valence
Advans SA SICAR – 100%	

APPLICABLE METHODOLOGY(IES)
Methodology: Micro Finance Banks (June 2019) https://www.vis.com.pk/kc-meth.aspx

Advans Pakistan Microfinance Bank Limited

OVERVIEW OF THE INSTITUTION

Advans Pakistan Microfinance Bank Limited (APMBL) was incorporated in 2012 as a public limited company under Microfinance Institutions Ordinance; 2001.The bank is licensed to operate in the province of Sindh.

Profile of Chairman

Dr. Claude Falgon serves as Chairman of the Board; his experience spans over 37 years during which he has chaired various organizations including La Fayette Participations and Advans International (Formerly Horus Development Finance). Mr. Claude has been associated with Advans SA since 2005.

Profile of CEO

Mr. Zine EL Abidine was appointed APMBL as CEO in 2016; previously he was serving the organization as Deputy CEO. Mr. Zine's experience spans over seventeen years during which he has undertaken various roles including CFO, Managing Director and CEO of various microfinance institutions.

RATING RATIONALE

Advans Pakistan Microfinance Bank Limited (APMBL) is engaged in provision of microfinance banking and related services to the poor and underserved segment of the society. At present, the bank operates with a network of 13 (2018: 11; 2017: 8) branches.

Rating Drivers

Microfinance Industry: In FY19, the performance of microfinance industry has been impacted by credit impairment (Gross Infection: Dec'19: 5.35, Dec'18: 2.4%). In absolute terms, the gross NPLs grew by 50%, with about half of the growth arising from livestock sector and the remaining from enterprises (29%) and agriculture sector (21%). The rise in impairment has impacted the profitability of the industry with RoAA & RoAE falling from 1.7% and 20.7% to -2.3% and -16.9% respectively. The industry OSS has dropped from 89.5% to 75.8%. With provisioning coverage at 70% and expectations of further rise in impairment, provisioning burden is likely to rise going forward. Industry liquidity has improved since prior year (liquid assets / deposits - Dec'19: 40.3%, Dec'18: 32.4%), while ADR has sustained at similar level. Even though the negative profitability has impacted the industry capitalization, the same is still considered to be adequately high (CAR/ Tier 1 CAR- Dec'19: 20.9% / 17.8%; Dec'18: 22.6% / 20.2%).

Shareholding: There has been a change in shareholding of the bank, as Netherland Finance Company (FMO) has divested its 25% stake in the bank and Advans SA Sicar (Advans SA) now holds 100% shareholding of the bank. The assigned ratings reflect sound profile of the sponsor, which has demonstrated commitment in form of both technical and financial assistance to APMBL in past. Recently, Advans SA forego their technical service fee of Rs. 73.8mn. In addition, the parent company has also made Rs. 50m capital injection in the bank and provided an emergency credit line of Rs. 100mn.

Credit Risk: Gross loan book of the bank posted growth of 27%, as the management opted to hold excess liquidity. However, overall growth in loan book exceeded the industry, with APMBL's market share (in terms of advances) growing from 0.5% to 0.6%. Management's efforts to increase average loan-size were partly successful, raising the average loan size from Rs. 90,624, as of Dec'18, to Rs. 110,727. In addition the active clientele of the bank increased by 4%, while average monthly disbursement increased from Rs.132m to Rs. 160m. Despite improvement in productivity indicators, over a timeline, the bank's progress continues to be hindered by the issue of attrition at CRO level. Akin to the industry, credit risk profile of APMBL has been impacted, with gross infection rising from 2.8% to 5.1%. the bank has made all required regulatory provisions, nevertheless, the provisioning coverage was on the lower side at 53.6%, while net infection stood at 3.3%, which is ~2x of industry.

Liquidity: The bank posted strong growth in deposits, increasing its market share from 0.2% to 0.4%. Nevertheless, liquidity risk has increased on a timeline, given lesser granularity in deposit base. Growth in deposits continues to materialize in form of fixed deposits which constituted 72% of the aggregate (Dec'18: 53%, Dec'17: 38%). Resultantly CASA (%) has reduced from 63% in Dec'18 to 28% as of Dec'19. Deposit concentration is significantly higher on a timeline basis, which is a source of concern as it makes the bank vulnerable to liquidity shortfalls. Cognizant of increasing liquidity risk, excess liquidity was partially retained, resulting in an increase in liquidity assets to deposits & borrowings (Dec'19: 33.1%; Dec'18: 23.6%). In addition, the management is also focusing proactively on managing relationship with large-sized depositors, in order to foresee any major withdrawals in advance. Furthermore, the expected slowdown in credit operations, wherein run offs are expected to exceed new disbursements, are expected to support liquidity buffers in the short term.

Profitability: Given the volumetric growth in markup bearing assets, improvement in spreads and reversal of contractual payment to parent company, the bank was able to achieve pre-tax breakeven in 2019. Much (85%) of the growth in recurring income was contributed by the higher net spread income, while the remaining (15%) arose from fee income. Given this growth in recurring income, the bank's Operational Self Sufficiency (OSS) depicted considerable improvement to 97.8% (2018: 80.3%) in 2019. However, the same still leaves room for improvement, as recurring income is still not sufficient to cover operating expenses. The company's core operating result in 2019 was a loss of Rs. 80.5m (2018: Rs. 121.7m). However, the bank was able to post pre-tax profit of Rs. 0.4m, mainly on account of other income to the tune of Rs. 80.9m; this mainly comprised reversal of contractual payment to the parent company to the amount of Rs. 73.8m.

Capitalization: Given realization of deferred tax asset of Rs. 14.5m in 2019, the bank's net equity grew. Nevertheless, given strong growth (35%) in risk-weighted assets, the capital adequacy of the bank receded from 43.4% to 31.3%, albeit still comparing favorably to peers. As of Dec'19, the bank's net equity stood at 525.3m against a regulatory requirement of Rs. 500m. Even though, at present the bank's CAR remains comfortably above the minimum CAR requirement of 15%, given the proximity to minimum equity floor, the bank's capitalization is a concern. Cognizant of this, the parent company has made an equity injection of Rs. 50m into the bank in Q1'2020. The equity infusion, along with improvement in profitability indicators is viewed positively. Even though the rising credit impairment, and higher net-NPLs to equity, is a source of concern, comfort is drawn from historical track record of parent-level support.

Advans Pakistan Microfinance Bank Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**2017**	**2018**	**2019**
Total Investments	-	-	98.5
Net Advances	558.6	978.0	1,234.7
Cash and Bank Balances	322.2	130.2	316.4
Total Assets	1,003.1	1,296.6	1,946.2
Deposits	301.6	552.3	953.72
Borrowings	-	100.0	300.0
Paid-up Capital	1,290	1,290	1,290
Tier-1 Equity	624.5	510.3	525.3
Net Worth	630.2	511.5	526.0
CAR	89.0%	42.9%	31.2%
INCOME STATEMENT	**2017**	**2018**	**2019**
Net Mark-up Income	138.3	265.5	393.4
Net Provisioning / (Reversal)	11.3	33.6	69.0
Non-Markup Income	41.4	56.8	151.3
Operating Expenses	302.8	402.1	475.4
Recurring Income	164.8	314.0	314.0
Core Earnings	(131.1)	(76.9)	(10.5)
Profit/ (loss) before Tax	(134.5)	(113.5)	0.4
Profit/ (loss) after Tax	(129.4)	(114.2)	14.9
RATIO ANALYSIS	**2017**	**2018**	**2019**
CA (%)	8.5%	16.4%	8.2%
CASA (%)	62.1%	47.5%	27.7%
Gross Infection (%)	2.2%	2.8%	5.1%
Net Infection (%)	1.5%	1.7%	3.3%
Incremental Infection (%)	3.5%	4.8%	7.9%
Net NPLs to Tier-1 Capital (%)	1.4%	3.3%	7.8%
Provisioning Coverage (%)	73.8%	72.1%	53.6%
Advances to Deposits (x)	1.88	1.81	1.33
Return on markup bearing assets (%)	23.1%	37.5%	41.2%
Cost of Funds (Deposits) (%)	4.9%	10.8%	13.4%
Markup Spreads (%)	18.3%	26.8%	27.8%
OSS (%)	55.7%	80.3%	97.8%
ROAA (%)	-15.3%	-9.9%	0.9%
Liquid Assets to deposits & borrowings (x)	1.1	0.2	0.3

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORYDISCLOSURES	**Appendix III**
Name of Rated Entity	Advans Pakistan Microfinance Bank Limited (APMBL)
Sector	Micro Finance Bank (MFB)
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
4/28/2020	BBB+	A-3	Rating Watch - Developing	Maintained
4/26/2019	BBB+	A-3	Stable	Reaffirmed
4/25/2018	BBB+	A-3	Stable	Reaffirmed
3/16/2017	BBB+	A-3	Stable	Reaffirmed
4/29/2016	BBB+	A-3	Stable	Reaffirmed
4/28/2015	BBB+	A-3	Stable	Reaffirmed
4/25/2013	BBB+	A-3	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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Due Diligence Meetings Conducted	

Name	Designation	Date
Mr. Awais Masood	CFO	April 22, 2020