RATING REPORT

The First MicroFinanceBank Limited (FMFB)

REPORT DATE:
March 29, 2019

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-1	A+	A-1
Rating Outlook	Stable		Stable	
Rating Date	*March 25th, '19*		*April 30th, '18*	

COMPANY INFORMATION

Incorporated in 2001	**External auditors:** M/s A. F. Ferguson & Co., Chartered Accountants, a member firm of the PwC network
Public Limited Unlisted Company	**Chairman of the Board**: Mr. Rayomond Kotwal
	President & CEO: Mr. Muhammad Amir Khan
Key Shareholders (with stake 5% or more):	
Habib Bank Limited (HBL): 50.5%	
Aga Khan Agency for Microfinance (AKAM): 20.9%	
Aga Khan Rural Support Programme (AKRSP): 11.0%	
International Finance Corporation (IFC): 8.8%	
Japan International Cooperation Agency (JICA): 8.8%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Micro Finance Banks (May 2016)
https://www.vis.com.pk/kc-meth.aspx

The First MicroFinanceBank Limited (FMFB)

OVERVIEW OF THE INSTITUTION

FMFB was incorporated in 2001 as a public limited unlisted company under the Companies Ordinance, 1984 (now Companies Act, 2017) and provides microfinance banking services to the market niche. The bank operates through a network of 203 business locations at end-FY18.

Profile of Chairman
Mr. Rayomond Kotwal has over 30 years of experience. Mr. Kotwal is currently the CFO of Habib Bank Limited.

Profile of CEO
Mr. Muhammad Amir Khan brings over 23 years of extensive experience in consumer and commercial banking with the Standard Chartered Bank, ABN Amro Bank and Royal Bank of Scotland.

Financial Snapshot
Total assets:
FY18 – Rs. 37.6b;
FY17 – Rs. 25.9b.

Total equity:
FY18 – Rs. 5.5b;
FY17 – Rs. 4.5b.

Net profit:
FY18 – Rs. 1.0b;
FY17 – Rs. 0.69b.

RATING RATIONALE

The assigned ratings take into account strong ownership profile as shareholding of the bank is vested with Habib Bank Limited, the largest commercial bank in Pakistan, Aga Khan Development Network and other international financial institutions. The ratings draw comfort from positive dynamics of microfinance sector and constructive regulatory environment. The ratings also factor in sustained growth in microcredit portfolio, emanating from expanding geographic penetration and increasing average loan size. The bank's infection ratios have remained one of the lowest among peer microfinance banks, though registering a marginal increase on a timeline basis. Considering increasing trend in sector-wide non-performing loans, the bank may further streamline its risk management framework. Moreover, positive momentum in profitability, resulting from growing core income and rationalized operational cost structure, continues to support FMFB's internal capital generation. The ratings also take into account enhanced resource allocation to digitalization efforts and strengthening of core functions and control environment. Maintenance of asset quality and leverage profile and arrest of declining trend in liquidity indicators are important rating parameters.

Key Rating Drivers

Business volume & Portfolio Indicators: FMFB showcased strong growth in gross loan portfolio during FY18, being one of the highest in the industry, on the back of higher disbursements, emanating from increase in average loan size and higher number of active borrowers. Two new products carrying higher limits were launched during FY18 to tap new market segments and reduce product concentration risk. In terms of sector-wise concentration, agriculture and livestock segments continue to account for half of the bank's overall portfolio, along with increase in micro-enterprise segment; the bank intends to maintain the mix, going forward. Overall, asset quality indicators of the bank remained largely intact.

Funding & Liquidity: FMFB remained dependent on deposits as the primary source of funding during FY18. The bank registered notable growth in deposits base during FY18; the growth primarily manifested in fixed and savings accounts. During FY18, the bank launched another liability product to attract high net worth and institutional clients. Consequently, further increase in concentration was noted as top-five depositors accounted for 26.3% of deposit base at end-FY18 (FY17: 20.4%); granularity is required with development of broader depositor base to improve the concentration risk profile. Overall, liquidity position of the bank is considered sound, though liquid assets to total deposits & borrowings ratio was recorded lower at end-FY18 that is still in line with most peer microfinance banks. Similarly, net advances to deposits ratio stood higher at 75.7% (FY17: 68.9%). The management plans to increase the said ratio at 82% by end-FY19 for optimal utilization of resources. Going forward, FMFB will remain focused on growing its deposit portfolio while mobilizing borrowings to bridge funding gaps only. The management intends to tap small businesses, salary accounts, and pension accounts to enhance current deposits.

Profitability & Capitalization: Profitability of the bank improved considerably during FY18 mainly on the back of notable growth in markup bearing assets. Despite higher cost of funds inline increasing interest rate scenario, the bank was able to sustain spreads mainly on the back of increasing advances to deposit ratio. Operational self-sufficiency remained high at 130% (FY17: 133%) on the back of considerable increase in core income despite that both markup expensed and provision against non-performing loans (including regulatory general provision) increased at relatively higher pace during FY18. Equity base of the bank augmented further with the retention of profits, and the Capital Adequacy Ratio (CAR) of the bank at 20% (FY17: 26%), remained well-above the minimum regulatory requirement despite some decline by end-FY18. The management intends to maintain CAR around 18% in the medium-term.

Controls and Digitalization: The management has been focusing on enhancing compliance and control environment. In this regard, the bank has implemented Transaction Monitoring /Anti-Money Laundering (AML) system and launched Compliance Certification program for all staff. The bank has deployed automation tools for monitoring, risk assessment, advance network protection firewalls and has also strengthened its information technology infrastructure. During FY18, the bank commercially launched its Digital Access Channels for efficient customer accessibility. The pilot testing of Loan Origination System (LOS) is currently in process and full-scale implementation is expected next year. Moreover, the pilot of phase-1 of Branchless Banking is expected between April and June, while the full-scale execution is planned by end-FY19.

The First MicroFinanceBank Limited (FMFB) Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**Dec 31, 2016**	**Dec 31, 2017**	**Dec 31, 2018**
Net Investments	4,628	5,934	2,807
Net Financing	8,183	14,395	23,554
Total Assets	16,878	25,941	37,625
Total Deposits	12,237	20,887	31,129
Borrowings	298	-	-
Tier-1 Equity	3,828	4,506	5,505
Net Worth	3,831	4,506	5,503
INCOME STATEMENT	**Dec 31, 2016**	**Dec 31, 2017**	**Dec 31, 2018**
Net Mark-up Income	1,899	2,863	4,365
Net Provisioning / (Reversal)	16	92	251
Non-Markup Income	171	302	509
Operating Expenses	1,560	2,062	3,112
Profit After Tax	316	686	1,001
RATIO ANALYSIS	**Dec 31, 2016**	**Dec 31, 2017**	**Dec 31, 2018**
Gross Infection (%)	0.7	0.7	0.9
Incremental Infection (%)	0.4	0.7	1.3
Provisioning Coverage (%)	23.9	23.2	32.7
Net Infection (%)	0.5	0.5	0.6
Net NPLs to Tier-1 Capital (%)	1.2	1.6	2.6
Capital Adequacy Ratio (%)	39.4	26.5	19.8
Cost of Funds (%)	5.4	5.6	6.7
Markup Spreads (%)	14.6	14.7	15.7
OSS (%)	121.3	133.4	129.9
ROAA (%)	2.2	3.4	3.1
ROAE (%)	11.0	16.5	20.0
Liquid Assets to Total Deposit & Borrowings (%)	60.5	46.8	35.4

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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.

REGULATORY DISCLOSURES						Annexure III
Name of Rated Entity	The First MicroFinanceBank Pakistan (FMFB)					
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			
	25/03/2019	A+	A-1	Stable	Reaffirmed	
	30/04/2018	A+	A-1	Stable	Reaffirmed	
	31/10/2017	A+	A-1	Stable	Reaffirmed	
	28/04/2017	A+	A-1	Stable	Reaffirmed	
	28/04/2016	A+	A-1	Stable	Upgrade	
	29/04/2015	A	A-1	Positive	Maintained	
	29/04/2014	A	A-1	Stable	Reaffirmed	
	30/04/2013	A	A-1	Stable	Reaffirmed	
	30/04/2012	A	A-1	Stable	Downgrade	
	28/04/2011	A+	A-1	Stable	Reaffirmed	
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.					
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.					
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