RATING REPORT

The First MicroFinanceBank Limited (FMFB)

REPORT DATE:
April 30, 2020

RATING ANALYSTS:

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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A+	A-1	A+	A-1
Rating Outlook	Rating Watch – Developing		Stable	
Rating Date	*April 30, '20*		*March 25th, '19*	

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): 29.7%	
Aga Khan Rural Support Programme (AKRSP): 11.0%	
Japan International Cooperation Agency (JICA): 8.8%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Micro Finance Banks (June 2019)
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 206 business locations at end-FY19.

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 24 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:
FY19 – Rs. 47.2b;
FY18 – Rs. 37.6b.

Total equity:
FY19 – Rs. 6.0b;
FY18 – Rs. 5.5b.

Net profit:
FY19 – Rs. 0.5b;
FY18 – Rs. 1.0b.

RATING RATIONALE

The First MicroFinanceBank Limited (FMFB) is one of the leading provider of microcredit service in Pakistan, with its growing network of 206 locations across Pakistan. The assigned ratings take into account strong ownership structure, as major shareholding of the bank is held by Habib Bank Limited (HBL) and the Aga Khan Development Network. Small change in shareholding structure was observed during the period under review as International Finance Corporation sold its shares (8%) to Aga Khan Agency for Microfinance. The assigned ratings take into account growth in microcredit portfolio, though at a slower pace, driven largely by growing footprint, number of disbursements and average loan size. The bank cutback new disbursements in high-risk locations to curtail credit risk. Asset quality indicators were under pressure during FY19, as reflected in considerable increase in infection ratios, leading to significant decline in profitability of the bank. Moreover, decline in liquidity and capitalization indicators was also noted during the year. The bank plans to acquire Tier-II capital, which will enhance Capital Adequacy Ratio (CAR) while supporting further expansion of microcredit portfolio.

Key Rating Drivers

Slowdown in business growth: Growth in gross loan portfolio was led by higher disbursements with increased focus on higher ticket loans, gradual increase in number of successive loan cycles to existing customers, higher number of active borrowers, backed by addition in new branches and upgrade of permanent booths/SOs during FY19. Growth rate in loan portfolio, however, was recorded at 33% (FY18: 64%) owing to cutback in new disbursements in high-risk locations amid mounting pressure of non-performing loans (NPLs). In line with the bank's overall strategy, the depth of product portfolio was enhanced with the launch of running finance facility under the ambit of Roshanzar Plus. During FY20, the bank intends to conduct a comprehensive assessment of its existing portfolio to make products more convenient with respect to their terms & conditions. In terms of sector-wise concentration, agriculture and livestock segments accounted for 52.7% (FY18: 50.9%) of overall portfolio owing to higher livestock lending, followed by microenterprise 28.2% (FY18: 28.2%) and other/general purpose to 19.1% (FY18: 20.9%). Overall mix is expected to remain largely stable, though the bank plans to slightly dilute its exposure to livestock and group-based microenterprise segments.

Asset quality: Asset quality of the bank came under pressure during FY19, mainly on account of slowdown in economic activity, rising inflation, and decline in yield of wheat, rice and cotton crops due to heavy rains. The unexpected decline in livestock sales in Sindh due to heavy rains during Eid-ul-Adha and closure of Afghan border also diluted borrowers' repayment ability during FY19. Moreover, the elevated indebtedness of borrowers by increasing geographic concentration and aggressive portfolio growth policies of the industry players also played its part. Resultantly, the bank recorded significantly higher NPLs of Rs. 1.1b (FY18: Rs. 214.3m), and gross and net infection ratios increased to 3.5% (FY18: 0.9%) and 2.4% (FY18: 0.6%), respectively, by end-FY19.

The pressure on asset quality is expected to remain elevated in FY20; the management has however taken various initiatives to curtail infection level by cutting-back on new disbursements in high-risk locations along with the reduction in limits, strengthening of early warning indicators framework, and increased focus on credit underwriting processes. The debt burden ratio and cash flow assessment criteria has been made more stringent. The bank-wide rollout of Loan Origination System (LOS) will strengthen credit approval process by enforcing improved credit controls and centralized monitoring of the same. Amendments in product parameters, modification in collateral needs, and tightening of risk acceptance criteria based on root cause analysis will also help manage credit risk more effectively.

Lower profitability due to increased provisioning and declining spreads: The bank reported lower profit before tax of Rs. 701m during FY19 (FY18: Rs. 1.5b), as the impact of growth in net markup income was more than offset by sizeable increase in provision against NPLs amounting 885m (FY18: Rs. 271m) and higher administrative expenses. Resultantly, Operational Self-Sufficiency declined to 108% (FY18: 130%). The increasing interest rate environment resulted in higher cost of funds during the period. The yield on markup bearing assets was positively impacted by higher return on investment portfolio and placements with other financial institutions, however, the bank remained competitive on product pricing in a bid to preserve its market share, which resulted in lower markup spread of 13.9% during FY19 (FY18: 15.7%).

Liquidity and capitalization indicators: Deposits remained the primary source of funding during FY19. Growth mainly manifested in saving deposits owing to the management's efforts to keep the deposit cost at a lower side. A dedicated sales force was formed during the year with aim to target small businesses, salary & pension, and transactional accounts. Concentration risk emanating from deposits portfolio is considered high as share of top-50 depositors stood higher at 59% by end-FY19 (FY18: 56%). Granularity is required with development of broader depositor base to improve risk profile. Liquidity indicators were under pressure, as depicted by further decrease in liquid assets to total deposits & borrowings ratio to 28.1% (FY18: 35.4%) by end-FY19. Similarly, net advances to deposits ratio stood higher at 80.6% (FY18: 75.7%). Going forward, the management plans to maintain the said ratio around 85%.

Equity base enhanced with retention of profits. Meanwhile, Capital Adequacy Ratio (CAR) was recorded lower at 15.8% at end-FY19 (FY18: 19.8%), slightly above the minimum regulatory requirement, on account of increase in risk-weighted assets and implementation of IFRS 16. FMFB has received an in-principle approval from the State Bank of Pakistan (SBP) for mobilization of secured, subordinated term finance facility of Rs. 2b from its parent company, Habib Bank Limited, for a tenor of 8 years with an option to make bullet repayment after the expiry of 5 years. The facility will not only contribute towards the bank's supplementary/tier-II capital for CAR but will also support the liquidity profile in a scenario of deferment of a major portion of current-year advances repayments as per the SBP's COVID-19 relief program. Issuance of the said facility within given timeline is considered important from ratings perspective.

The First MicroFinanceBank Limited (FMFB) Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**
Cash & balances with SBP and NBP	1,205	2,187	2,876
Balances with other Banks/NBFIs/MFBs	2,639	6,037	3,405
Net Investments	5,934	2,807	4,513
Net Financing	14,395	23,554	30,936
Other Assets	1,768	3,040	5,502
Total Assets	25,941	37,625	47,232
Total Deposits	20,887	31,129	38,404
Borrowings	-	-	-
Other Liabilities	548	993	2,781
Tier-1 Equity	4,506	5,505	6,048
Net Worth	4,506	5,503	6,047
Paid-Up Capital	2,731	2,731	2,731
INCOME STATEMENT	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**
Net Mark-up Income	2,863	4,365	5,054
Net Provisioning / (Reversal)	92	251	853
Non-Markup Income	302	509	768
Operating Expenses	2,062	3,112	4,268
Profit Before Tax	1,007	1,511	701
Profit After Tax	686	1,000	533
RATIO ANALYSIS	**Dec 31, 2017**	**Dec 31, 2018**	**Dec 31, 2019**
Gross Infection (%)	0.7	0.9	3.5
Incremental Infection (%)	0.7	1.3	5.0
Provisioning Coverage (%)	23.2	32.7	33.6
Net Infection (%)	0.5	0.6	2.4
Net NPLs to Tier-1 Capital (%)	1.6	2.6	12.1
Capital Adequacy Ratio (%)	26.5	19.8	15.8
Cost of Funds (%)	5.6	6.7	10.5
Markup Spreads (%)	14.7	15.7	13.9
OSS (%)	133.4	129.9	108.1
ROAA (%)	3.4	3.1	1.3
ROAE (%)	16.5	20.0	9.2
Liquid Assets to Total Deposit & Borrowings (%)	46.8	35.4	28.1

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Annexure III

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 Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
30/04/2020	A+	A-1	Rating Watch – Developing	Maintained
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

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. Ali Raza Anjum	Chief Operating Officer	March 4, 2020
Mr. Adil Ali Abbasi	Chief Financial Officer	March 4, 2020
Ms. Zehra Khalikdina	Head, Risk Management	March 4, 2020
Mr. Muhammad Siddique	Head, Internal Audit	March 4, 2020