

RATING REPORT

FINCA Microfinance Bank Limited (FINCA MFB)

REPORT DATE:

May 06, 2020

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	Rating Watch Developing		Stable	
Rating Date	April 30, '20		April 30, '19	

COMPANY INFORMATION

Incorporated in 2008	External auditors: M/S KPMG Taseer Hadi & Co
Public Limited Company	Chairperson of the Board: Ms. Zarlisht Wardak
	CEO: Mr. Farid Ahmed Khan
Key Shareholders (with stake 5% or more):	
FINCA Microfinance Cooperatief U.A - 86.4%	
Kashf Holdings(Private) Limited – 5.2%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Micro-Finance Banks (May 2016)

<http://www.vis.com.pk/kc-meth.aspx>

FINCA Microfinance Bank Limited

OVERVIEW OF THE INSTITUTION RATING RATIONALE

FINCA Microfinance Bank Limited (FINCA MFB) previously Kashf Microfinance Bank Limited, was incorporated in June, 2008 as a public limited company under the Companies Ordinance, 1984. The ultimate holding company of FINCA MFB is FINCA Impact Finance, a not-for-profit corporation incorporated in Washington D.C., U.S.

Profile of CEO

Mr. Farid has been involved with financial sector for over 25 years and has a broad experience in Microfinance, Fund Management, Investment Banking, Investment Research and Business Development. Prior to joining FINCA Pakistan, he spent 10 years in investment management side as CEO of HBL Asset Management and ABL Asset Management. He had served on the Board of the bank for three years.

Financial Snapshot

Total Equity: FY19: Rs. 4.7b; FY18:Rs. 4.0b; 2017: Rs. 3.3b
 Net profit: FY19: Rs. 653m; FY18: Rs. 957m; FY17: Rs. 855m

The assigned ratings of FINCA MFB incorporate association of the bank with FINCA Impact Finance., a global microfinance organization operating in 20 subsidiaries, including Pakistan. FINCA MFB continues to receive support from its parent through transfer of technical expertise emanating from FINCA’s global experience. FINCA MFB has successfully embarked upon various IT initiatives, which are expected to bring operational efficiencies, going forward. The ratings take into account the currently manageable liquidity position of the bank coupled with improvement in capitalization indicators emanating from sizeable investment in risk free avenues as growth in micro-credit portfolio was limited. The ratings reflect slight downturn in the financial risk profile of the bank owing to higher incidence of non-performing loans leading to higher infection ratios; the same is a result of deterioration in sector dynamics prior to advent of COVID-19 pandemic. The downturn in asset quality has put a drag on the institution’s profitability; however the deterioration in the same is below industry averages.

With the advent of global corona virus pandemic and the following lockdown, the microfinance borrowers and especially those in urban areas will have a further reduced capacity of meeting obligations. The ratings take into account SBP’s relaxation on repayment terms for borrowers by giving a blanket extension of one year; however, VIS expects that the same will only stagger the infection ratios, which will eventually come forth by end-FY21. Also the liquidity management may pose challenges in the backdrop of collections being reduced due to loans payment deferment and outstanding deposit liability. Status of the rating is therefore uncertain, as an event of deviation from expected trend has occurred; additional information will be necessary to take any further rating action, warranting a ‘Rating Watch’ status. Going forward, ratings are dependent on achievement of projected growth plans while improving asset quality indicators, strengthening deposit profile and retaining buffer over regulatory capital requirement.

Credit Risk FINCA MFB: Limited growth was achieved in the micro-credit portfolio during the outgoing year as a result of consolidation of branch network leading to merger of branches. The market share of the bank slight declined to 7.4% during FY19 as compared to 7.6% in the preceding year. Individual lending continues to remain forte of the bank, while average loan ticket size continued to increase on a timeline basis. A higher loan size continues to provide competitive advantage to FINCA over other MFBs in terms of lower operational cost incurred per individual loan initiated. Further, owing to progression of clients to successive loan cycles along with inflationary pressure and adequate cash flow assessment of clients , per party exposure does not constitute a significant risk. The bank’s loan book reflects an adequate diversification of agricultural, livestock and enterprise loans and among Equal Monthly Installment (EMI) and Bullet repayment structures. Credit risk emanating from microcredit portfolio exhibited an increasing trend indicated by higher infection ratio, which has plummeted for the past few years. The management must continue to ensure prudent risk management as majority of the portfolio comprises agricultural & livestock based loans. As a result, the management has embarked upon various risk mitigation initiatives including post-disbursement screening mechanism, pre-disbursement screening of SE

products, deployment of regional compliance officers, 90-day write-off structure; impact of the same will be seen over time. Future trend with respect to asset quality indicators will continue to be tracked by VIS.

Liquidity: Liquidity profile of the bank is adequate; however high depositor concentration levels and increasing advances to deposit ratio remain a rating concern. Improvement in deposit profile (including depositor concentration and mix) remains a key focus area of the management. Deposits remained the primary funding source for the bank; deposit mix largely remained the same with term deposits comprising more than two-third of the deposit base. Further, depositor concentration increased on a timeline basis with top 50 depositors accounting for 34% (FY18: 31%) of total deposits. Going forward, stickiness in deposits coupled with maintained granularity in deposit base is required to mitigate the impact of large withdrawals. Going forward, the management plans to increase granularity by introducing low-ticket sticky deposits through branchless banking project.

Profitability: Despite increase in mark-up spreads and slight increase in the number of loans disbursed, profitability of the bank took a downward trend primarily owing to exponential increase in administrative and provisioning expense of the bank along with suspension of markup income. Given higher provisioning expense recorded coupled with sizable increase in administrative expenses. Operating Self Sufficiency (OSS) declined on a timeline basis. Going forward, profitability of FINCA MFB is projected to depict positive momentum owing to growth in financing portfolio only if the deteriorating asset quality indicators are addressed. Maintaining asset quality indicators will remain a key rating driver.

The bank projects yield on advances to decline further on account of possible regulatory pressures on product prices while cost of funds is projected to decline on account of lower benchmark rate in the ongoing COVID-19 pandemic scenario; thereby resulting in improvements of spreads. Going forward the OSS is projected to rationalize owing to operational efficiencies primarily on the back of various IT initiatives, improved LO productivity and lower turnaround time.

Capitalization: By end-FY19, equity of the bank augmented on the back of internal capital generation. CAR of the bank improved during the review period on account of range bound growth manifested in advances portfolio and relatively higher excess liquidity parked in risk free investments. However, given growth plans, sizeable internal capital generation would be required to maintain CAR above the minimum regulatory requirement. The same is likely to be attained if the deterioration in asset quality is countered effectively.

FINCA Microfinance Bank (FINCA MFB)
Appendix I

FINANCIAL SUMMARY					
(amounts in Rs. Millions)					
BALANCE SHEET	Dec 31, 2015	Dec 31, 2016	Dec 31, 2017	Dec 31, 2018	Dec 31, 2019
Net Investments	1,039.2	1,885.3	5,209.1	3,827.5	6,244.5
Net Financing	5,418.7	10,082.3	14,863.3	20,580.5	22,038.8
Cash Balances	766.6	2,058.2	2,533.1	4,128.7	3,238.2
Total Assets	8,451.9	15,618.0	25,141.9	32,279.8	37,311.9
Total Deposits	6,057.4	11,070.0	19,183.9	23,741.8	23,911.3
Borrowings	115.0	1,350.0	1,669.0	3,318.5	5,552.9
Paid Up Capital	2,260.0	2,260.0	2,260.0	2,260.0	2,260.0
Tier-1 Equity	1,915.2	2,420.0	3,275.1	4,030.0	4,714.6
Net Worth	1,933.5	2,432.6	3,283.2	4,032.4	4,718.3
INCOME STATEMENT					
	Dec 31, 2015	Dec 31, 2016	Dec 31, 2017	Dec 31, 2018	Dec 31, 2019
Net Mark-up Income	1,365.1	2,338.5	3,552.5	4,702.9	5,314.4
Net Provisioning / (Reversal)	105.7	219.2	406.6	434.9	1,089.6
Non-Markup Income	326.2	549.8	693.5	801.9	954.5
Operating Expenses	1,340.0	1,681.4	2,461.2	3,489.9	4,167.7
Profit before tax	245.2	987.6	1,378.3	1,580.0	1,011.6
Profit after tax	166.7	630.9	854.8	956.5	653.4
RATIO ANALYSIS					
	Dec 31, 2015	Dec 31, 2016	Dec 31, 2017	Dec 31, 2018	Dec 31, 2019
Gross Infection	2.3%	1.1%	1.5%	1.9%	4.7%
Incremental Infection	3.0%	1.0%	2.9%	3.1%	7.2%
Provisioning Coverage	11.4%	26.0%	35.7%	21.7%	22.1%
Net Infection	2.1%	0.8%	1.0%	1.5%	3.7%
Net NPLs to Tier-1 Capital	5.8%	3.5%	4.4%	7.6%	17.4%
Capital Adequacy Ratio	30.5%	20.6%	18.5%	15.9%	19.8%
Cost of Funds	9.2%	7.6%	7.7%	7.85%	10.1%
Markup Spreads	22.0%	24.5%	20.2%	19.74%	19.36%
OSS	111.8%	138.5%	133.3%	126.3%	111.3%
ROAA	2.2%	5.6%	4.2%	3.3%	1.9%
ROAE	10.5%	29.7%	29.8%	26.2%	14.9%
Liquid Assets to Total Deposit & Borrowings (%)	29.3%	31.8%	37.1%	29.4%	33.1%
Current Ratio (x)	NA	NA	NA	NA	NA

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix 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		Appendix VI			
Name of Rated Entity	FINCA Microfinance Bank (FINCA MFB)				
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				
	30-Apr-20	A	A-1	Rating Watch Developing	Maintained
	30-Apr-19	A	A-1	Stable	Reaffirmed
	23-Apr-18	A	A-1	Stable	Reaffirmed
	31-Oct-17	A	A-1	Stable	Reaffirmed
	27-Apr-17	A	A-1	Stable	Reaffirmed
	09-Jan-17	A	A-1	Stable	Upgrade
	26-April-16	A-	A-2	Positive	Reaffirmed
	30-April-15	A-	A-2	Positive	Maintained
	30-April-14	A-	A-2	Stable	Upgrade
	30-April-13	BBB+	A-3	Stable	Upgrade
	09-May-12	BBB-	A-3	Rating Watch - Developing	Downgrade
	29-April-11	BBB	A-3	Rating Watch - Developing	Maintained
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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